

BSE SENSEX 38,370 S&P CNX 11,308

CMP: INR213

TP: INR300 (+40%)

Buy

Motilal Oswal values your support in the Asiamoney Brokers Poll 2020 for India Research, Sales and Trading team. We request your ballot.



Bloomberg	GUJS IN
Equity Shares (m)	564
M.Cap.(INRb)/(USD\$b)	120.1 / 1.6
52-Week Range (INR)	263 / 146
1, 6, 12 Rel. Per (%)	-3/-4/-4
12M Avg Val (INR M)	152

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
Sales	19.4	19.7	22.9
EBITDA	15.7	15.9	18.4
PAT	11.1	10.0	11.2
EPS (INR)	19.7	17.8	19.9
EPS Gr. (%)	39.5	-9.5	11.6
BV/Sh.(INR)	119.2	134.6	152.0

Ratios

Net D:E	-0.6	-0.7	-0.7
RoE (%)	17.8	14.0	13.9
RoCE (%)	17.5	14.0	14.4
Payout (%)	12.2	13.5	12.1

Valuations

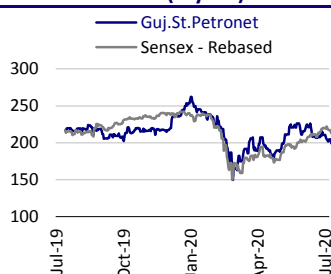
P/E (x)	10.8	11.9	10.7
P/BV (x)	1.8	1.6	1.4
EV/EBITDA (x)	7.9	7.3	5.7
Div. Yield (%)	0.9	0.9	0.9
FCF Yield (%)	12.1	8.1	11.7

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	37.6	37.6	37.6
DII	33.6	33.9	33.8
FII	15.5	15.8	15.4
Others	13.2	12.7	13.2

FII Includes depository receipts

Stock Performance (1-year)



Large appetite for growth...

Upcoming LNG terminals and pipelines to aid transmission volumes

- Available LNG regas capacity is expected to jump 54% from the current 24mmtpa to 40mmtpa over the next 2-3 years in Gujarat, presenting huge volume growth opportunity for Gujarat State Petronet (GUJS).
- On the gas evacuation front, reach of LNG terminals such as the Anjar-Chotila expansion and partial completion of the 77mmscmd/76mmscmd Mehsana-Bhatinda/Mallavaram-Bhilwara pipelines should increase to the rest of India.
- Additionally, there are five industrial clusters in Gujarat classified as severely/critically polluted. A strict action like Morbi could increase transmission volumes for GUJS.
- We believe that Gujarat Gas (GUJGA) could see a major boost in volume CAGR of ~10% over the medium term on the highest volume base amongst peers ([link to report](#)).
- At 25% holding company discount, the 54% stake in Gujarat Gas (and 27.5% stake in Sabarmati Gas) provides a valuation of INR141/share for GUJS, implying 3.6x FY22E P/E for the standalone business. The stock is trading at 10.7x FY22E P/E and we value GUJS at 8x standalone and reiterate Buy with a target price of INR300/share.

Gujarat to equal South Korea (third largest importer) in 2-3 years

- Overall, Gujarat is expected to have an available capacity of 40mmtpa over the next 2-3 years, up 54% from now. South Korea, the third largest LNG consumer, imported a total of 40.1mmt of LNG in 2019.
- Swan Energy is expected to come up with its 5mmtpa LNG terminal at Jafrabad by end-2021. It has firm contracts of 4.5mmtpa (GSPC: 1.5, IOCL: 1, BPCL: 1, ONGC: 1) already. HPCL-Shapoorji is expected to complete its 5mmtpa LNG terminal at Chhara in another 2-3 years.
- GSPC's Mundra LNG terminal could be operated at full 5mmtpa capacity (v/s current ~1.5mmtpa) once the Anjar-Chotila pipeline capacity is augmented.
- Additionally, Dahej is expected to increase its capacity by 2.0mmtpa on addition of two tanks and a third jetty.
- All these factors provide GUJS with huge potential to carry an additional 15.5mmtpa of gas on its grid (i.e. ~56mmscmd v/s current yearly volumes of ~40-42mmscmd).
- The company currently has pipeline capacity of ~42mmscmd. Considering the above volumes, we believe capex is inevitable.

Pipeline infrastructure ramping up for evacuation of incremental gas

- GSPL India Gasnet (GIGL) (GSPL: 52%, IOCL: 26%, BPCL: 11%, HPCL: 11%) is executing partial stretches of Mehsana-Bhatinda (340km) and Mallavaram-Bhilwara (364km) pipelines. Both have capacity of 76-77mmscmd and would enable evacuation of gas from upcoming LNG terminals.
- GUJS is already transporting ~40-42mmscmd of gas. Even if the last mile pipeline connectivity of Chhara and Swan is executed by other companies, the gas would eventually flow through GUJS's network. This demands an increase in its network capacity.

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Required capex to diminish concerns on sharp tariff reduction

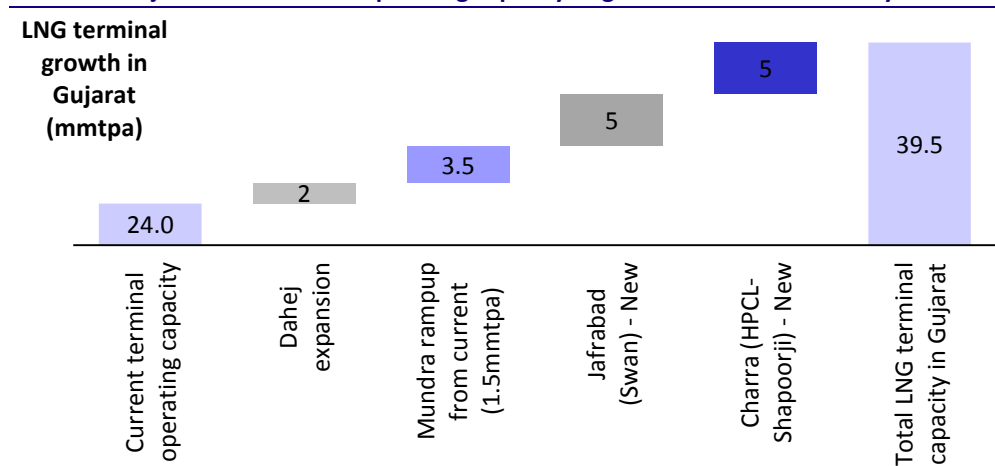
- GUJS has moved to the lower tax rate. As a result, the regulator might cut its tariffs by 10-12% to maintain regulated RoCEs.
- Additionally, GUJS has two pipeline grids – High Pressure (HP) and Low Pressure (LP) – with their economic lifetime being defined as 2026 and 2025, respectively.
- The current tariffs of INR34/mmBtu and INR4.08/mmBtu for HP and LP networks, respectively, have been determined by using the above lifetimes. However, they are likely to get an extension, which may entail a decrease in tariff.
- The HP network's tariff of INR34/mmBtu was approved on the basis of 26mmscmd of transmission volume from FY20. However, against this, the transmission volume stands at 38mmscmd in FY20.
- The above positives call for a cut in transmission tariff of the HP network. **However, we understand that the company may spend INR18b on spur lines and capacity augmentation by end-FY23. Also, the company plans on spending another ~INR22b over the next 3-4 years as capacity utilization increases from the upcoming terminals.** This is against the NFA of INR43b for the HP pipeline when its tariff was decided in 2018.

Valuation and view – Trading at cheapest core business valuation

- So far, the regulator has not cut tariff for the lower tax rate adjustment. However, it is likely to be docked soon. As per our model assumptions, for every 10% change in tariff, the sensitivity to change in EBITDA/EPS of GUJS is 12/15%, respectively.
- **Exhibit 2 highlights EBITDA sensitivity to change in tariffs (5%/10%/20%), in line with upcoming capacities over the next 5 years.** Even at tariff reduction of ~20%, expected EBITDA CAGR over FY21-25 is 10%, while tariff reduction of 5% would result in EBITDA CAGR of ~17% over the same period.
- **GUJS generated FCF of ~INR14.5b in FY20 and our model estimates suggest that FCF generation for FY21-22E combined could be ~INR23.5b.** The company plans on using the excess cash flow for capacity expansion, and thus, would try and keep implied tariffs at the same level (as IRR is based on gross block).
- The stock trades at 10.7x FY22E EPS of INR19.9 and 5.7x FY22E EV/EBITDA, and we value the stock using SoTP.
- Using 25% holding company discount, 54% stake in GUJGA and 27.5% stake in Sabarmati Gas amounts to INR141/share for GUJS (*refer exhibit 3 - GUJS core trades at 2-6x FY22E EPS given various holding company discounts*). We value the standalone at 8x FY22E to arrive at a target price of INR300 for the stock. Reiterate **Buy** (with an upside of ~40%).
- Stricter action against usage of industrial pollution would further increase the demand of gas and may result in much higher transmission volumes than considered. On the other hand, non-approval of capex proposed by GUJS, resulting in a sharp tariff cut remains the biggest risk.

Even considering the more imminent incremental volumes (PLNG’s utilization track record along with strong JV affiliations, ramp-up at Mundra to full capacity and firm contracts with Swan Energy), additional volumes of ~8mmtpa (i.e. ~28.8mmscmd – ~70% growth on current volumes of ~40-42mmscmd), are likely in the near term.

Exhibit 1: Gujarat LNG terminal operating capacity to grow ~65% over next 3-4 years



Source: PPAC, MOFSL

Exhibit 2: GUJS sensitivity to change in tariff – even at 20% reduction, expected EBITDA CAGR is 10% over FY21-25E

Assuming following increase in LNG terminal capacity utilizations (mmtpa):

	Mundra @ 1.5	Mundra @ 2.5	Mundra @ 3.5 Jafrabad @ 2.0	Mundra @ 4.5 Jafrabad @ 3.5 Dahej @18.5	Mundra @ 4.5 Jafrabad @ 4.5 Dahej @19.5 Swan @1.0	EPS CAGR
Sensitivity to change in tariff	FY21E	FY22E	FY23E	FY24E	FY25E	FY21-25
Volumes (mmscmd)	37.7	42.0	52.8	65.4	76.2	
Volumes addition (mmscmd)		4.3	10.8	12.6	10.8	
Tariff (INR/mmbtu) - 5% reduction	34.0	32.3	32.3	32.3	32.3	
EBITDA* estimates (INR mn)	13,121	13,566	17,054	21,124	24,612	17%
Tariff (INR/mmbtu) - 10% reduction	34.0	30.6	30.6	30.6	30.6	
EBITDA* estimates (INR mn)	13,121	12,532	15,754	19,514	22,736	15%
Tariff (INR/mmbtu) - 20% reduction	34.0	27.2	27.2	27.2	27.2	
EBITDA* estimates (INR mn)	13,121	10,463	13,154	16,293	18,983	10%

*only gas transmission business EBITDA Source: MOFSL

We value GUJS at 8x FY22E EPS, which is a ~33% discount to its forward Long Term P/E average of 11.8x

Exhibit 3: GUJS core trades at 2-6x FY22E EPS given various holding company discounts

			Base case	Bear case	Bull case
			at 25% discount	at 50% discount	at 10% discount
	FY22 EPS	P/E multiple	Value/share	Value/share	Value/share
GUJS core	19.9	8	159	159	159
Investments			141	94	169
Target price			300	253	328
CMP			213	213	213
Investments as % of CMP			66%	44%	80%
Core trading at			3.6	5.9	2.2

Source: MOFSL

Exhibit 4: GUJS's natural gas pipelines under development

Name of Pipeline	Name of Entity	Length (km)	Capacity (mmscmd)	States through which it passes
1 Mehsana-Bhatinda	GSPL India Gasnet Limited	2,052.0	77.1	Gujarat, Rajasthan, Haryana, Punjab
2 Bhatinda-Jammu-Srinagar	GSPL India Gasnet Limited	725.0	42.4	Punjab, Jammu & Kashmir
3 Mallavaram-Bhopal -Bhilwara via Vijapur	GSPL India Transco Limited	2,042.0	76.3	Andhra Pradesh, Telangana, Madhya Pradesh, Rajasthan
Total		4,774.0	195.8	

...as on 30th Sep'19... Source: PPAC, MOFSL**Exhibit 5: Various consumers along the route of Mehsana-Bhatinda pipeline**

Sector/Industry/Consumer	Location
Cement plants	Gujarat
Fertilizer plants	Gujarat
Refinery/Petchem units	Gujarat
Gas based IIPs	Gujarat
Textile mills	
Bulk industrial consumers	
Industrial and CGD projects along the pipeline route	
Jaipur Udaipur Jodhpur Ajmer Chittorgarh Alwar Bhiwadi	Rajasthan
Bhiwani Rohtak Sirsa	Haryana
Bhatinda Patiala Ambala	Punjab
Chandigarh	Chandigarh

Source: PNGRB, MOFSL

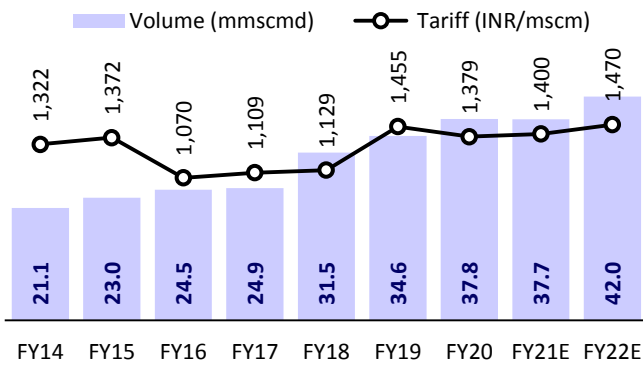
Exhibit 6: LNG terminal India – total utilization at existing terminals stands ~63.5% at end-Mar'20

Existing terminals	Nameplate capacity (mmt)	State	Company	Throughput (mmtpa)				Utilisation	
				FY19	3MFY20	6MFY20	9MFY20	FY20	FY20 (%)
Dahej	17.5	Gujarat	PLNG	16.0	16.3	17.8	17.2	18.0	103
Kochi	5	Kerala	PLNG	0.2	0.2	0.7	0.8	0.5	9
Hazira	5	Gujarat	Shell	4.0	4.8	5.0	4.7	4.9	98
Dabhol	5	Maharashtra	GAIL, NTPC	1.2	0.1	0.2	0.9	1.6	33
Ennore	5	Tamil Nadu	IOCL				0.4	0.5	9
Mundra	5	Gujarat	Adani, GSPC					1.5	30
Total existing capacity	42.5			21.3	21.4	23.8	23.9	27.0	63.5
Gujarat total	27.5			20.0	21.1	22.8	22.0	24.4	
Under construction									
Jaigarh (FSRU)	4	Maharashtra	H Energy						
Dhamra	5	Odisha	Adani						
Jafrabad (FSRU)	5	Gujarat	Swan						
Charra	5	Gujarat	HPCL, Shapoorji Pallonji						
Total under construction capacity	19								
Gujarat total	10								
Proposed terminals									
East Coast	5	Odisha	PLNG						
Kukrahati	3	West Bengal	H Energy						
Total proposed capacity									
Total potential LNG capacity	69.5								

Source: PLNG, MOFSL

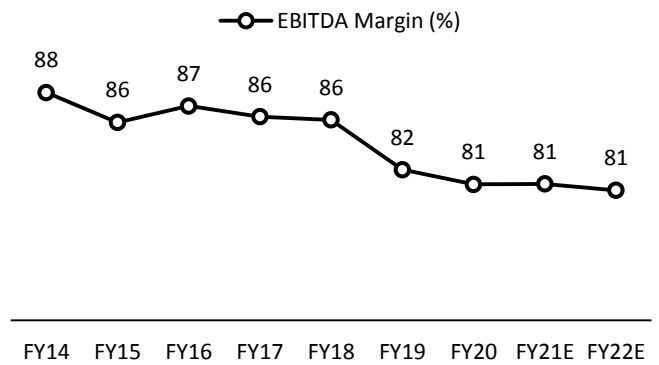
Story in charts

Exhibit 7: GUJS's volume to stay strong...



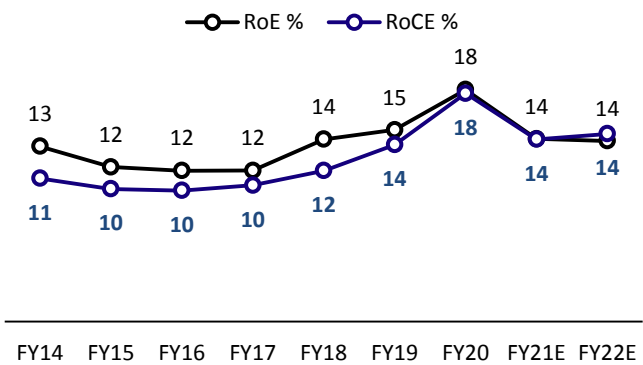
Source: Company, MOFSL

Exhibit 8: ...with strong EBITDA margin



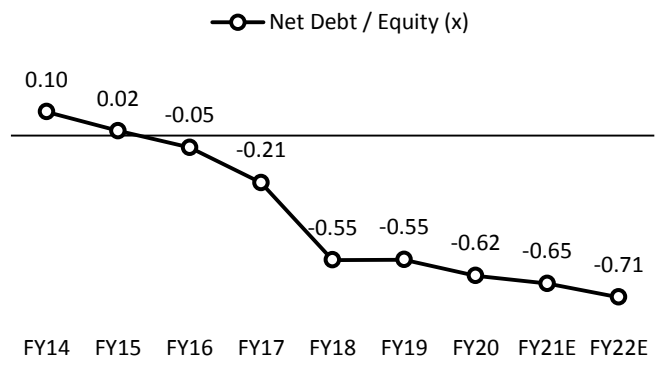
Source: Company, MOFSL

Exhibit 9: Return ratios to stay strong



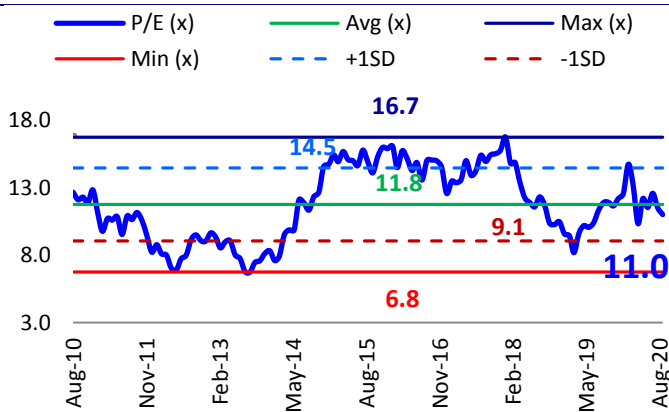
Source: Company, MOFSL

Exhibit 10: Net debt to decline



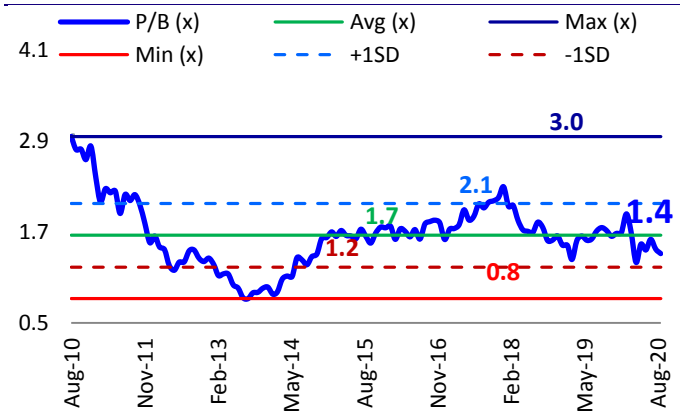
Source: Company, MOFSL

Exhibit 11: GUJS 1-year forward P/E trades at ~7% discount to its LT average of 11.8x...



Source: Company, MOFSL

Exhibit 12: ...while 1-year forward P/B trades at a discount of ~18% to LT average of 1.7x



Source: Company, MOFSL

Financials and Valuations

Standalone - Income Statement

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Total Income from Operations	10,646	9,919	10,276	13,318	18,773	19,449	19,664	22,911
Change (%)	1.3	-6.8	3.6	29.6	41.0	3.6	1.1	16.5
EBITDA	9,154	8,660	8,883	11,478	15,426	15,749	15,932	18,446
Margin (%)	86.0	87.3	86.4	86.2	82.2	81.0	81.0	80.5
Depreciation	1,892	1,829	1,791	1,750	1,800	1,966	2,195	2,488
EBIT	7,262	6,831	7,092	9,728	13,626	13,783	13,738	15,958
Int. and Finance Charges	1,178	799	596	354	2,192	1,645	979	1,632
Other Income	520	656	882	735	594	649	649	649
PBT after EO Exp.	6,603	6,688	7,378	10,108	12,028	12,786	13,408	14,974
Total Tax	2,500	2,235	2,412	3,424	4,081	1,699	3,375	3,773
Tax Rate (%)	37.9	33.4	32.7	33.9	33.9	13.3	25.2	25.2
Reported PAT	4,104	4,454	4,966	6,685	7,947	11,087	10,033	11,201
Change (%)	-2.1	8.5	11.5	34.6	18.9	39.5	-9.5	11.6
Margin (%)	38.5	44.9	48.3	50.2	42.3	57.0	51.0	48.9

Standalone - Balance Sheet

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Equity Share Capital	5,630	5,633	5,636	5,638	5,640	5,641	5,641	5,641
Total Reserves	30,601	35,058	39,324	45,012	51,800	61,584	70,261	80,106
Net Worth	36,230	40,692	44,960	50,650	57,440	67,226	75,902	85,747
Total Loans	11,575	10,670	6,305	17,595	12,856	5,441	5,441	5,441
Deferred Tax Liabilities	4,504	4,724	4,719	4,984	5,226	4,081	4,081	4,081
Capital Employed	52,309	56,085	55,984	73,229	75,522	76,748	85,425	95,270
Gross Block	48,193	33,059	35,277	36,512	43,245	44,994	48,392	51,117
Less: Accum. Deprn.	17,539	1,829	3,620	5,371	7,170	9,137	11,331	13,819
Net Fixed Assets	30,654	31,230	31,657	31,142	36,075	35,857	37,060	37,298
Capital WIP	7,765	7,679	6,864	8,959	4,194	2,372	1,974	1,541
Total Investments	6,487	7,311	7,655	41,814	42,772	46,111	46,111	46,111
Curr. Assets, Loans&Adv.	10,498	12,243	12,158	7,571	6,459	5,764	13,792	26,229
Account Receivables	1,504	1,518	1,216	1,235	2,081	1,637	1,655	1,928
Cash and Bank Balance	4,352	5,529	8,026	3,645	1,583	957	8,935	20,530
Loans and Advances	3,540	4,019	1,792	1,456	1,516	1,908	1,930	2,248
Curr. Liability & Prov.	3,094	2,378	2,350	16,256	13,978	13,356	13,513	15,910
Account Payables	405	150	138	185	238	410	414	495
Other Current Liabilities	1,776	2,088	2,088	15,932	13,523	12,670	12,820	15,090
Provisions	913	140	124	138	216	276	279	325
Net Current Assets	7,404	9,865	9,808	-8,685	-7,518	-7,592	279	10,319
Appl. of Funds	52,309	56,085	55,983	73,229	75,522	76,748	85,425	95,269

E: MOFSL Estimates

Financials and Valuations

Ratios

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
EPS	7.3	7.9	8.8	11.9	14.1	19.7	17.8	19.9
Cash EPS	10.6	11.1	12.0	15.0	17.3	23.1	21.7	24.3
BV/Share	64.2	72.2	79.7	89.8	101.8	119.2	134.6	152.0
DPS	1.2	1.5	1.5	1.8	2.0	2.0	2.0	2.0
Payout (%)	19.9	22.8	20.5	16.9	16.1	12.2	13.5	12.1
Valuation (x)								
P/E	29.1	26.8	24.1	17.9	15.0	10.8	11.9	10.7
Cash P/E	19.9	19.0	17.7	14.2	12.3	9.2	9.8	8.7
P/BV	3.3	2.9	2.7	2.4	2.1	1.8	1.6	1.4
EV/Sales	11.9	12.6	11.5	10.0	7.0	6.4	5.9	4.6
EV/EBITDA	13.9	14.4	13.3	11.6	8.5	7.9	7.3	5.7
Dividend Yield (%)	0.6	0.7	0.7	0.8	0.9	0.9	0.9	0.9
FCF per share	7.3	7.6	14.9	33.4	10.9	25.7	17.1	24.7
Return Ratios (%)								
RoE	11.9	11.6	11.6	14.0	14.7	17.8	14.0	13.9
RoCE	10.2	10.1	10.5	11.6	13.6	17.5	14.0	14.4
RoIC	13.3	13.1	13.8	24.6	39.3	44.0	36.9	43.0
Working Capital Ratios								
Fixed Asset Turnover (x)	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Asset Turnover (x)	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2
Inventory (Days)	38	43	40	34	25	24	24	24
Debtor (Days)	52	56	43	34	40	31	31	31
Creditor (Days)	14	6	5	5	5	8	8	8
Leverage Ratio (x)								
Current Ratio	3.4	5.1	5.2	0.5	0.5	0.4	1.0	1.6
Interest Cover Ratio	6.2	8.5	11.9	27.5	6.2	8.4	14.0	9.8
Net Debt/Equity	0.0	-0.1	-0.2	-0.6	-0.5	-0.6	-0.7	-0.7

Standalone - Cash Flow Statement

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
OP/(Loss) before Tax	6,603	6,688	7,378	10,108	12,028	12,786	13,408	14,974
Depreciation	1,892	1,829	1,791	1,750	1,800	1,966	2,195	2,488
Interest & Finance Charges	720	402	50	-381	1,598	997	330	984
Direct Taxes Paid	-2,195	-2,062	-2,228	-3,424	-4,081	-1,699	-3,375	-3,773
(Inc)/Dec in WC	-871	-650	2,534	14,112	-3,229	373	107	1,555
CF from Operations	6,149	6,208	9,526	22,166	8,116	14,423	12,664	16,227
CF from Operating incl EO	6,268	6,027	9,436	22,166	8,116	14,423	12,664	16,227
(Inc)/Dec in FA	-2,151	-1,767	-1,052	-3,331	-1,967	73	-3,000	-2,292
Free Cash Flow	4,117	4,259	8,384	18,835	6,148	14,496	9,664	13,935
(Pur)/Sale of Investments	-386	-824	-346	-34,159	-958	-3,339	0	0
CF from Investments	-2,166	-1,877	-573	-36,357	-1,965	-4,635	-2,351	-1,644
Inc/(Dec) in Debt	-2,713	-978	-4,329	11,290	-4,739	-7,414	0	0
Interest Paid	-1,389	-1,208	-1,039	-354	-2,192	-1,645	-979	-1,632
Dividend Paid	-658	-813	-1,017	-1,128	-1,283	-1,357	-1,356	-1,356
CF from Fin. Activity	-4,743	-2,972	-6,366	9,810	-8,213	-10,415	-2,335	-2,988
Inc/Dec of Cash	-641	1,178	2,497	-4,381	-2,062	-627	7,978	11,595
Opening Balance	4,992	4,352	5,529	8,026	3,645	1,583	957	8,935
Closing Balance	4,352	5,529	8,026	3,645	1,583	957	8,935	20,530

E: MOSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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