



Gujarat State Petronet Limited

Strong Q3, value pick

Oil & Gas

Sharekhan code: GSPL

Result Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

Reco/View

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 233	
Price Target: Rs. 300	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

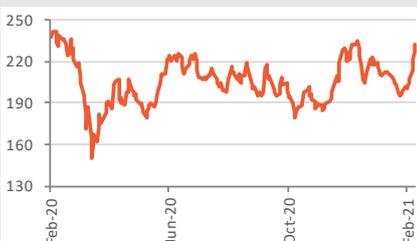
Company details

Market cap:	Rs. 13,143 cr
52-week high/low:	Rs. 247 / 146
NSE volume: (No of shares)	9.5 lakh
BSE code:	532702
NSE code:	GSPL
Free float: (No of shares)	35.2 cr

Shareholding (%)

Promoters	37.6
FII	15.9
DII	20.0
Others	26.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10	23	9	-3
Relative to Sensex	6	5	-25	-27

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 operating profit/PAT at Rs. 398 crore/Rs. 248 crore exceeded estimates by 6%/9% led by 3.6% beat in gas transmission volume and lower-than-expected operating cost and depreciation.
- Volumes would be temporarily affected in Q4FY2021 (to decline 14% q-o-q to 33-34 mmscmd) due to lower offtake from refineries. Long-term outlook is intact led by regulatory push and unified tariffs. Spot LNG price has corrected to \$6.5/mmBtu and would aid volume growth.
- Core pipeline business is effectively available free to investors as market value of GSPL's investment in Gujarat Gas (after assuming 20% holding company discount) is close to GSPL's current market capitalisation of Rs. 13,143 crore). Hence, we see deep value for investors in GSPL.
- We maintain our Buy rating on GSPL with an unchanged PT of Rs. 300 given strong earnings growth outlook, revival of capex plan (Rs. 500 crore for FY22) and management focus to become debt free.

Gujarat State Petronet Limited's (GSPL) Q3FY2021 results were ahead of ours as well as street's expectations with a 6% beat in operating profit at Rs. 398 crore (up 4.8% y-o-y; up 4.6% q-o-q) led by higher-than-expected gas transmission volume at 39.4 mmscmd (up 6.6% y-o-y; down 1% q-o-q) and efficient cost management (overall opex down by 26.1% y-o-y and 7.5% q-o-q). Implied transmission tariff was largely stable and stood Rs. 1.58/scm (up 1.8% q-o-q). Volumes from CGD/fertiliser sector increased sharply by 86%/24% q-o-q to 12.6 mmscmd/3.9 mmscmd, which offset volume decline from other sectors (23% and 9% q-o-q volume decline from refineries/petchem and power sectors, respectively to 9.1 mmscmd and 7.1 mmscmd). PAT at Rs. 248 crore (up 11.4% y-o-y) was also 9% above our estimate of Rs. 228 crore, led by higher volume, lower operating cost and depreciation (down 7.8% q-o-q). The management indicated that gas transmission volume likely to decline by 14% q-o-q to 33-34 mmscmd in Q4FY2021 as offtake from refineries was lower over January-February 2021 given unfavourable economics of spot LNG. However, volumes are now reaching normalized level as demand has improved with sharp correction in spot LNG price to ~\$6.5/mmBtu. We believe that regulatory support (curb on pollution, auction of new CGD areas and unified gas pipeline tariff) and revival of capex plan (guided for Rs. 500 crore for FY2022 versus cumulative capex of Rs. 450-500 crore FY2019-FY2021E) bodes well for long-term volume growth. We highlight here that GSPL's core pipeline business is effectively available free to investors as the market value of GSPL's investment in Gujarat Gas (after assuming 20% holding company discount) is close to GSPL's current market capitalisation of Rs. 13,143 crore. Hence, we maintain a Buy on GSPL with an unchanged SoTP-based PT of Rs. 300.

Key positives

- Better-than-expected gas transmission volume at 39.4 mmscmd (up 6.6% y-o-y).
- Sharp decline in overall operating cost by 26.1% y-o-y and 7.5% q-o-q due lower gas transmission cost and other expenses.

Key negatives

- Employee costs rose sharply by 24.7% y-o-y.

Our Call

Valuation – Maintain Buy on GSPL with an unchanged PT of Rs. 300: We have fine-tuned our FY2021-FY2023 earnings estimates. Regulatory tailwinds (unified tariff and open access), affordable gas price and proximity to LNG terminals (27.5mtpa re-gas capacity) makes GSPL a strong bet on the robust outlook for gas demand in India. Moreover, Gujarat Gas' (GSPL's CGD subsidiary) earnings outlook is promising, given a high exposure of 77% to industrial gas volumes and is expected to create long-term value for investors. We highlight here that GSPL's core pipeline business is effectively available free to investors as the market value of GSPL's investment in Gujarat Gas (after assuming 20% holding company discount) is close to GSPL's current market capitalization of Rs. 13,143 crore). Hence, we maintain a Buy on GSPL with an unchanged SoTP based price target (PT) of Rs. 300.

Key Risks

Lower-than-expected gas demand from power, fertilisers, refineries and CGD due to a spike in LNG prices could impact gas transmission volumes. Any adverse regulatory changes in term of gas transmission tariffs. Delay in volume ramp-up at new LNG terminals.

Valuations (Standalone)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	1,877	2,369	2,167	2,403	2,593
OPM (%)	82.2	66.5	67.2	69.3	70.4
Adjusted PAT	795	1,109	933	1,124	1,254
YoY growth (%)	18.9	39.5	-15.9	20.5	11.6
Adjusted EPS (Rs.)	14.1	19.7	16.5	19.9	22.2
P/E (x)	16.5	11.9	14.1	11.7	10.5
P/B (x)	2.3	2.0	1.7	1.5	1.4
EV/EBITDA (x)	9.9	9.3	9.5	7.7	6.5
RoNW (%)	14.7	17.8	13.1	14.0	13.8
RoCE (%)	16.2	16.4	14.8	15.8	15.7

Source: Company; Sharekhan estimates;

Note: Valuation is based on current market capitalization which includes value of 54% stake in Gujarat Gas

Operating profit/PAT beat estimate led by better-than-expected volumes, lower opex and depreciation

Q3FY2021 results were ahead of ours as well as street's expectations with a 6% beat in operating profit at Rs. 398 crore (up 4.8% y-o-y; up 4.6% q-o-q) led by higher-than-expected gas transmission volume at 39.4 mmscmd (up 6.6% y-o-y; down 1% q-o-q) and cost management (overall opex down by 26.1% y-o-y and 7.5% q-o-q). Implied transmission tariff was largely stable and stood Rs. 1.58/scm (up 1.8% q-o-q). Volumes from CGD/fertiliser sector increased sharply by 86%/24% q-o-q to 12.6 mmscmd/3.9 mmscmd, which offset volume decline from other sectors (23% and 9% q-o-q volume decline from refineries/petchem and power sectors, respectively to 9.1 mmscmd and 7.1 mmscmd). PAT at Rs. 248 crore (up 11.4% y-o-y) was also 9% above our estimate of Rs. 228 crore, led by higher volume, lower operating cost and depreciation (down 7.8% q-o-q).

Key takeaways from discussion with management

- ◆ **Business update and volume guidance** – The management indicated that gas transmission volumes were severely impacted in January and February 2021 (so far) as offtake from refineries declined due to a sharp rise in spot LNG prices (which makes consumption of spot LNG uneconomical for refiners). Thus, management guided for q-o-q decline in gas transmission volume to 33-34 mmscmd in Q4FY2021 versus 39.4 mmscmd in Q3FY2021. However, volume offtake has largely normalised now as spot LNG prices have corrected to ~\$6.5/mmBtu.
- ◆ **Long-term volume growth guidance** – The management has guided for 10% y-o-y volume growth for FY2022. Also, the company is implementing projects for expansion of its current pipeline network as its high-pressure gas pipeline is operating close to full utilisation. These pipeline projects would take 18 months to get completed.
- ◆ **Gas transmission tariff outlook** – The management does not expect any material cut in transmission tariff (in next revision cycle of 2022) except for 10% related to adjustment for lower effective income tax rate.
- ◆ **Capex guidance** – The management has guided for capex of Rs. 100-150 crore for FY2021 and Rs. 500 crore for FY2022. Large part of FY2022 capex would be spent in H2FY2022.
- ◆ **Meshana-Bhatinda pipeline update** – The construction work on the pipeline is 90% completed and commissioning is expected in the next three months. The management expects total gas transmission volume of 10mmscmd in next 10-12 months and pipeline is expected to make cash profits from first year of operation.
- ◆ **Debt** – GSPL's standalone debt stood at Rs. 1,040 crore as on December 2020 and the company aims to be debt-free in the next three quarters.

Results					Rs cr	
Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %	
Net Sales	580	626	-7.3	577	0.5	
Total Expenditure	182	246	-26.1	196	-7.5	
Reported operating profit	398	380	4.8	381	4.6	
Adjusted operating profit	398	380	4.8	381	4.6	
Other Income	7	5	44.5	52	-85.6	
Interest	22	38	-42.6	25	-11.8	
Depreciation	51	50	2.7	55	-7.8	
Exceptional income/(expense)	0	0	NA	0	NA	
Reported PBT	333	297	12.0	352	-5.4	
Adjusted PBT	333	297	12.0	352	-5.4	
Tax	85	75	13.6	81	5.6	
Reported PAT	248	222	11.4	271	-8.7	
Adjusted PAT	248	222	11.4	271	-8.7	
Equity Cap (cr)	56	56		56		
Reported EPS (Rs.)	4.4	3.9	11.4	4.8	-8.7	
Adjusted EPS	4.4	3.9	11.4	4.8	-8.7	
Margins (%)			BPS		BPS	
Adjusted OPM	68.7	60.7	795	66.0	271	
Effective tax rate	25.6	25.3	37	22.9	267	
NPM	42.7	35.5	717	47.0	-432	

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %
Gas transportation volume (mmscm)	3,621	3,398	6.6	3,657	-1.0
Gas transportation volume (mmscmd)	39.4	36.9	6.6	39.8	-1.0
Implied transmission tariff (Rs. /scm)	1.6	1.82	-13.2	1.6	1.8
EBITDA (Rs. /scm)	1.1	1.1	-1.6	1.0	5.7

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Infrastructure expansion and regulatory push to drive strong gas demand

We expect strong growth in transmission volumes for gas utilities like GAIL and GSPL to be supported by robust gas demand outlook, which in turn would be due to: 1) higher demand from the power, CGD and fertiliser sectors, 2) regulatory push to switch to gas from polluting industrial/auto fuels and 3) low domestic gas price and affordable LNG prices. Moreover, recently notified unified tariffs for gas pipeline operators (although revenue neutral in short term) provides a massive volume opportunity and would drive growth in the long term. India's gas demand has also recovered above pre-COVID-19 level to 182 mmscmd versus 127 mmscmd in April 2020. The sharp recovery in gas demand has been driven by an all-round recovery in demand from power, fertilisers, CGD, petrochemicals and refineries.

■ Company outlook - Robust volume growth visibility to drive 16% PAT CAGR over FY21E-FY23E

We expect a strong growth in GSPL's gas transmission volume led by 3-5 mmscmd volume from revival of stranded power plants given expectation of affordable spot LNG price in near to medium term, 2 mmscmd supply to new fertiliser plants and GSPC's 2 mmscmd of LNG contracts. Hence, we expect GSPL's gas transmission volume to grow 11%/8% in FY2022E/FY2023E while transmission tariffs are expected to remain stable at Rs. 1.3/scm. We thus expect GSPL's EBITDA/PAT to grow at 12%/16% CAGR over FY2021E-FY2023E.

■ Valuation - Maintain Buy on GSPL with an unchanged PT of Rs. 300

We have fine-tuned our FY2021-FY2023 earnings estimates. Regulatory tailwinds (unified tariff and open access), affordable gas price and proximity to LNG terminals (27.5mtpa re-gas capacity) makes GSPL a strong bet on the robust outlook for gas demand in India. Moreover, Gujarat Gas' (GSPL's CGD subsidiary) earnings outlook is promising, given a high exposure of 77% to industrial gas volumes and is expected to create long-term value for investors. We highlight here that GSPL's core pipeline business is effectively available free to investors as the market value of GSPL's investment in Gujarat Gas (after assuming 20% holding company discount) is close to GSPL current market capitalization of Rs. 13,143 crore). Hence, we maintain a Buy on GSPL with an unchanged SoTP based price target (PT) of Rs. 300.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

GSPL, a group entity of the GSPC group, is currently a Gujarat focused natural gas transmission firm operating on an open access basis. It owns approximately 2,500 km natural gas pipeline transporting ~38-40 mmscmd of gas. To increase its geographical spread it had participated and won bids to put up 3 major pipelines outside Gujarat (1) Mallavaram (Andhra Pradesh) - Bhilwara (Rajasthan), (2) Mehsana (Gujarat) - Bhatinda (Punjab), and (3) Bhatinda (Punjab) - Srinagar (J&K). GSPL owns stake in two city gas distribution firms – Sabarmati Gas and Gujarat Gas. It is the second largest gas pipeline player in the country after GAIL.

Investment theme

Higher gas supplies with a new LNG terminals, affordable LNG prices, government's target to increase share of gas in India's energy mix to ~15% by 2015 (from 6% currently) and thrust to reduce pollution provide strong gas transmission volume opportunity for GSPL. Investment in CGD space (Gujarat Gas and Sabarmati Gas) to create long-term value for investors. Core pipeline business is effectively available free to investors as value of investment in GGAS is equal to GSPL's current market capitalization.

Key Risks

- ◆ Lower than expected gas demand from power, fertiliser and CGD due to spike in LNG prices could impact gas transmission volume.
- ◆ Any adverse regulatory changes in term gas transmission tariff.
- ◆ Delay in volume ramp-up at new LNG terminals

Additional Data

Key management personnel

Anil Mukim	Chairman and Managing Director
Sanjeev Kumar	Joint Managing Director
Ajith Kumar T R	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	GUJARAT MARITIME BOARD	6.6
2	Mirae Asset Global Investments Company	5.2
3	DSP EQUITY SAVINGS	3.0
4	DSP Investment Managers Pvt Ltd	3.0
5	Franklin Resources Inc	2.5
6	Tata Asset Management Ltd	2.4
7	Gujarat Urja Vikas Nigam Ltd	2.0
8	Kotak Mahindra Asset Management Company	2.0
9	GOVERNMENT PENSION FUND - GLOBAL	1.8
10	Gujarat Narmada Valley Fertilizers	1.4

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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