



3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey	Red
Right Quality (RQ)	Green	Grey	Red
Right Valuation (RV)	Green	Grey	Red
	+ Positive	= Neutral	- Negative

What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Green	↔	Green

ESG Disclosure Score NEW

ESG RISK RATING Updated Jun 08, 2023 **34.32**

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 16,723 cr
52-week high/low:	Rs. 311/209
NSE volume: (No of shares)	7.6 lakh
BSE code:	532702
NSE code:	GSPL
Free float: (No of shares)	35.2 cr

Shareholding (%)

Promoters	37.6
FII	16.7
DII	24.9
Others	20.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.4	8.1	16.7	39.9
Relative to Sensex	0.4	(1.1)	11.1	18.9

Sharekhan Research, Bloomberg

Gujarat State Petronet Ltd

Improved earnings outlook; core pipeline business attractively valued

Oil & Gas	Sharekhan code: GSPL		
Reco/View: Buy	↔	CMP: Rs. 296	Price Target: Rs. 342 ↔
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- GSPL's earnings outlook has improved considerably, given the steep decline in spot LNG price and cap on APM gas price. Thus, we expect strong volume recovery over FY2024-FY2025 from CGD/refinery and petchem sectors, which could take GSPL's volume to ~32 mmscmd (implies 25% y-o-y growth) in FY2024.
- Favourable amendments (in November 2022) to gas pipeline tariff bode well for revival in gas pipeline capex cycle (GSPL has planned capex of ~Rs. 3,000 crore to connect the pipeline to new LNG terminals in Gujarat), which would support GSPL's tariff.
- Gujarat state government's recent policies would support shareholders' returns, as GSPL has already increased dividend payout to 30% and we see a possibility of share buyback (companies with cash of >Rs. 1,000 crore to exercise buyback), given rising cash on books amid high FCF generation (Rs. 777 crore in FY2023).
- We maintain Buy on GSPL with an unchanged PT of Rs. 342 as the core pipeline business is available at only 2x its FY2025E EPS.

The recent sharp decline in spot LNG price to ~\$11-12/mmbtu and cap on APM gas price at \$6.5/mmbtu have considerably improved volume recovery outlook for Gujarat State Petronet Limited (GSPL) and the same is visible in strong 18%/12% q-o-q increase in gas transmission volume from CGDs/refinery and petchem sectors. We believe normalised CGD/refinery and petchem volume would take GSPL's FY2024 volume to ~32 mmscmd, which implies significant growth of 25% y-o-y. Long-term volume growth would be supported by the new LNG terminals. Amendments in the gas pipeline tariff would help accelerate the capex plan (>Rs. 3,000 crore over the next 4-5 years), which bode well for the gas pipeline tariff. We expect GSPL's PAT to report a 13% CAGR over FY2023-FY2025E. We highlight here that FY2023 had the advantage of material benefit from take-or-pay charges in gas pipeline tariff. We maintain our Buy rating on GSPL with an unchanged price target (PT) of Rs. 342.

- Expect strong volume recovery in FY2024; robust long-term volume growth potential:** Post the steep decline of 40% in gas transmission volume during Q3FY2022-Q3FY2023, GSPL's Q4FY2023 volume had shown signs of recovery, thanks to the steep fall in spot LNG price. With the current spot LNG price at \$11-12/mmbtu, we expect real positive impact on GSPL's gas transmission volume would be seen in FY2024 when we expect robust recovery in demand from CGD/refinery and petchem sectors. We highlight here that a normalised CGD/refinery and petchem volume would take GSPL's FY2024 volume to ~32 mmscmd, which implies significant growth of 25% y-o-y. Furthermore, GSPL has already connected Jafrabad/ Mundra LNG terminal to its pipeline and construction work is going on to connect the Charra LNG terminal (90 kms gas pipeline). Additionally, Petronet LNG's Dahej expansion to 22.5mtpa would also be over by FY2025. These LNG terminals (total capacity of 22.5 mtpa) provide a massive long-term volume growth opportunity for GSPL. Thus, we expect sustainable 10% y-o-y volume growth for GSPL.
- New tariff guideline – To accelerate capex, which bodes well for tariff:** PNGRB announced several amendments to gas pipeline tariff regulations in November 2022, including increased time period for capacity utilisation ramp-up, allowing unaccounted gas, lower tax rate would be applicable from FY2024, and not retrospective and exclusion of new gas source for tariff calculation for five years. These amendments bode well for gas pipeline tariff; thus, we expect GSPL's capex plan of >Rs. 3,000 crore over the next five years (to connect new LNG terminals) to accelerate and the same would support gas pipeline tariff. Also, the impact from the shift to lower tax rate regime of 25.17% (versus 33.3% earlier) on GSPL's tariff is expected to be much lower than street's expectation of 15-20% as tariff amendments exclude the impact of lower tax rate on tariff for FY2021-FY2023 as it is prospective i.e., from FY2024.
- Gujarat government's new policies – To improve shareholder's return:** Gujarat state government has recently announced new policies for state PSUs, which include – 1) minimum levels of dividend distribution (minimum 30% of profit or 5% of net worth, whichever is higher), 2) share buybacks (PSU with a net worth of at least Rs. 2,000 crore and cash and bank balance of Rs. 1,000 crore to exercise the option to buy back its shares), and 3) bonus shares (if reserve and surplus are equal to or more than 10x paid-up equity share capital). We believe the recent policies would support shareholders' returns as GSPL has already increased dividend payout to 30% and we see a possibility of share buyback (companies with cash of >Rs. 1,000 crore to exercise buyback), given rising cash on books amid high FCF generation (Rs. 777 crore in FY2023).

Our Call

Valuation – Maintain Buy on GSPL with an unchanged SoTP-based PT of Rs. 342: Regulatory tailwinds, potential higher domestic gas production, and proximity to LNG terminals make GSPL a strong long-term bet on the robust outlook for gas demand in India. We highlight here that GSPL's core pipeline business (excluding the market value of GSPL's investment in Gujarat Gas after assuming a 20% holding company discount) is valued at just 2x its FY2025E EPS. Moreover, Gujarat state government's recent policies on dividend distribution and share buyback would improve shareholder's return in the coming years. Hence, we maintain our Buy rating on GSPL but with an unchanged SoTP-based PT of Rs. 342.

Key Risks

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

Valuation (Standalone)

Particulars	FY22	FY23	FY24E	FY25E
Revenue	2,020	1,762	1,958	2,247
OPM (%)	69.2	71.4	73.1	75.4
Adjusted PAT	979	945	1,022	1,212
YoY growth (%)	5.2	-3.5	8.1	18.6
Adjusted EPS (Rs)	17.4	16.7	18.1	21.5
P/E (x)	17.1	17.7	16.4	13.8
P/B (x)	2.0	1.8	1.6	1.5
EV/EBITDA (x)	12.0	12.7	11.5	9.2
RoNW (%)	12.2	10.7	10.5	11.3
RoCE (%)	13.8	12.1	12.3	13.2

Source: Company; Sharekhan Estimates; Note: Valuation is based on the current market capitalisation, which includes value of a 54% stake in Gujarat Gas

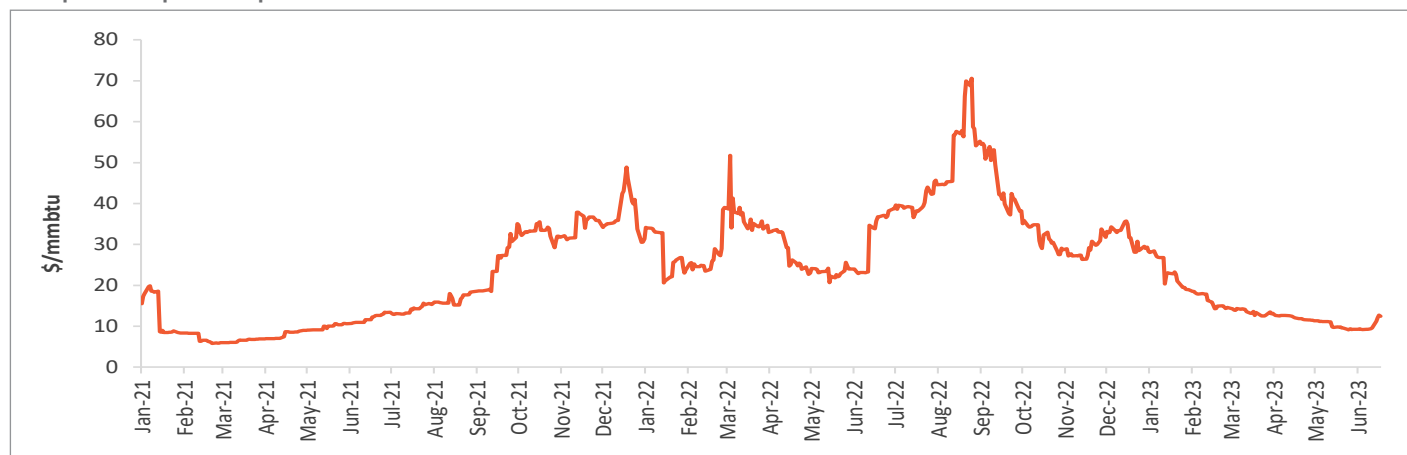
Lower gas price to drive strong recovery in gas transmission volume – Expect a 20% volume CAGR over FY2023-FY2025E

GSPL's gas transmission volume was severely impacted in FY2022-FY2023 as a steep rise in spot LNG, contracted LNG, and APM gas price impacted demand from sectors like CGD, refinery and petchem, and power. However, from mid-January 2023, gas prices started to decline sharply and now spot LNG price is hovering at \$11-12/mmbtu, which is much lower compared with the average spot LNG price of \$31/mmbtu in FY2023 and peak of \$70/mmbtu seen on August 30, 2022. Moreover, the steep decline in Brent crude oil price has also moderated contracted LNG price, while the Indian government has capped APM gas price at \$6.5/mmbtu versus \$8.6/mmbtu in H2FY2023.

Post the steep decline of 40% in GSPL's gas transmission volume during Q3FY2022-Q3FY2023, GSPL's Q4FY2023 volume had shown signs of recovery, thanks to the steep fall in the spot LNG price. With the current spot LNG price at \$11-12/mmbtu, we expect a real positive impact on GSPL's gas transmission volume would be seen in FY2024 when we expect robust recovery in demand from CGD/refinery and petchem sectors. We highlight here that normalised CGD/refinery and petchem volume would take GSPL's FY2024 volume to ~32 mmscmd, which implies significant growth of 25% y-o-y. We expect a robust 20% volume CAGR over FY2023-FY2025E.

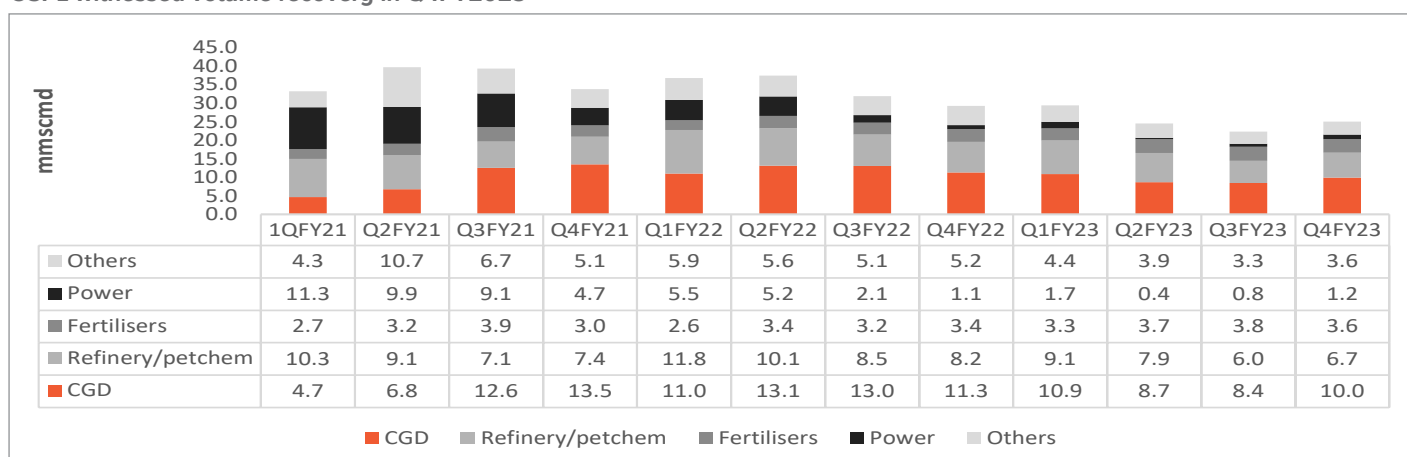
Furthermore, GSPL has already connected Jafrabad/Mundra terminal to its pipeline and construction work is going on to connect Charra LNG terminal (90 km pipeline). Additionally, Petronet LNG's Dahej expansion to 22.5mtpa would be over by FY2025. These LNG terminals (total capacity of 22.5 mtpa) provide a massive long-term volume growth opportunity for GSPL. , Thus, we expect sustainable long-term 10% y-o-y volume growth for GSPL.

Sharp fall in spot LNG price



Source: Bloomberg

GSPL witnessed volume recovery in Q4FY2023



Source: Company; Sharekhan Research

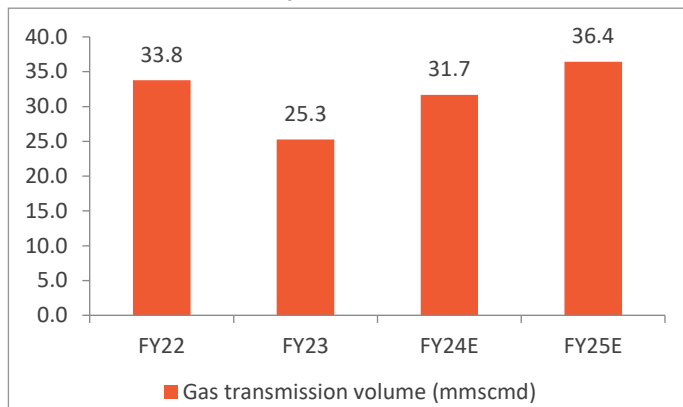
Gas pipeline tariff reforms – To support capex revival and pipeline tariff

The Petroleum and Natural Gas Regulatory Board (PNGRB) in November 2022 made key amendments to natural gas pipeline tariff regulations and we perceive them as positive for GSPL, as they remove the long pending overhang on tariff. In our view, GSPL's gas pipeline tariff would benefit from prospective implementation of lower tax rate from FY2024 (versus retrospective impact from FY2021-FY2023) and allowance of transmission loss at 0.1% of the actual volume. Amendments for volume ramp-up (capacity utilization ramp-up to 10 years versus 5 years earlier) and exclusion of new gas sources for five years for tariff calculation would play a crucial part in the revival of capex cycle (GSPL has a capex plan of >Rs. 3,000 crore for the next couple of years to connect new LNG terminals in Gujarat).

We believe the impact of the shift to a lower tax rate regime of 25.17% (versus 33.3% earlier) on GSPL's tariff is expected to be much lower than street's expectation of 15-20%, as tariff amendments exclude the impact of lower tax rate on tariff for FY2021-FY2023 as it is prospective i.e., from FY2024. Additionally, allowing transmission loss at 0.1% of the actual volume, multiplied by the gas price, would further support GSPL's tariff.

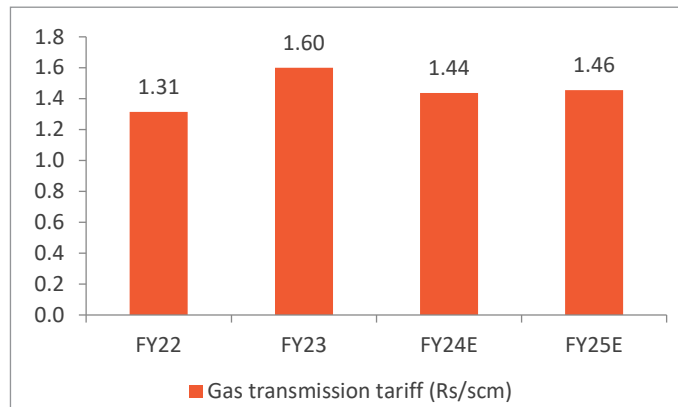
Financials in charts

Gas transmission volume to post a 20% CAGR over FY2023-FY2025E



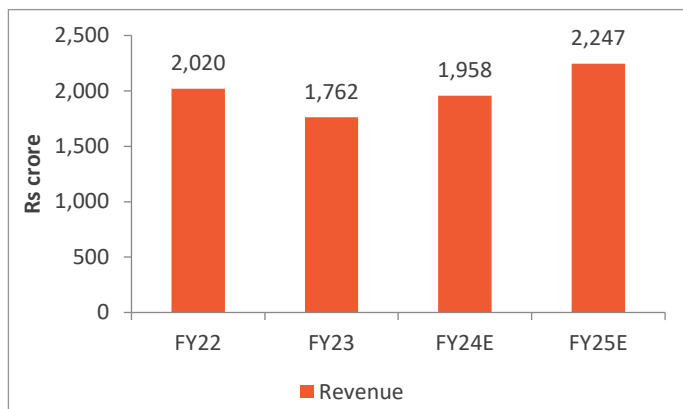
Source: Company, Sharekhan Research

Transmission tariff to decline in FY2024



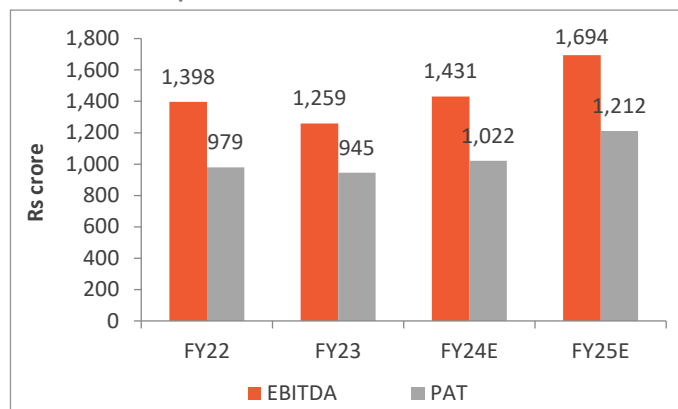
Source: Company, Sharekhan Research

Revenue trend



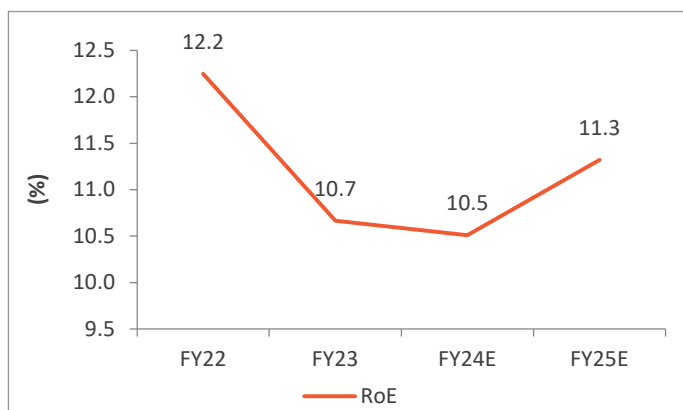
Source: Company, Sharekhan Research

EBITDA/PAT to post a 16%/13% CAGR over FY23-FY25E



Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



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 such as GAIL and GSPL to be supported by robust gas demand outlook, which in turn would be due to: 1) demand recovery from the CGD, refineries and fertiliser sectors, 2) regulatory push to switch to gas from polluting industrial/auto fuels, and 3) recent sharp decline in spot LNG price. Moreover, the recently notified unified tariff for gas pipeline operators (although it is revenue neutral in the short term) provides a massive volume opportunity and would drive growth in the long term. However, any spike in international gas price remains a key challenge to recovery in volume growth for gas utilities.

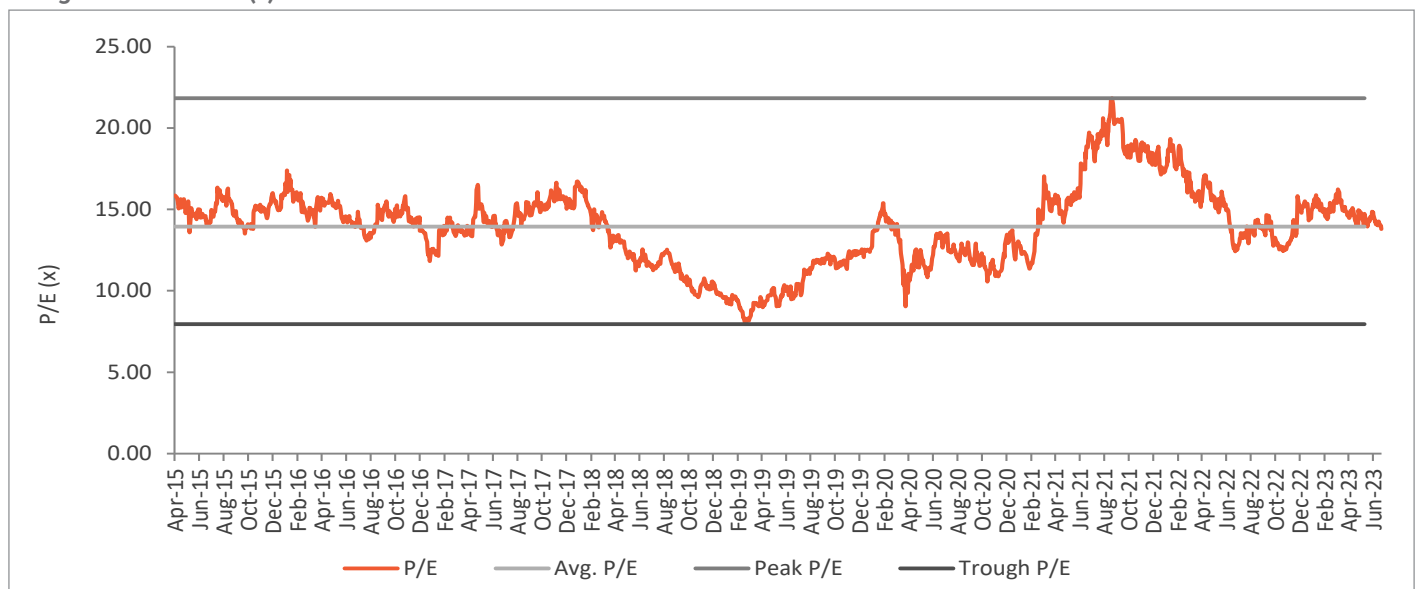
■ Company outlook - Volume recovery to drive earnings growth

We expect GSPL's gas transmission volume to recover in the coming quarters, given the recent steep fall in spot LNG price. We expect GSPL's gas transmission volume to increase strongly at a 20% CAGR over FY2023-FY2025E on a low base of FY2023 (volume decline of 25% y-o-y). Amendments in natural gas pipeline tariff regulations are positive and we model net transmission tariff of Rs. 1.4-1.5/scm over FY2024E-FY2025E post the expectation of a 10% cut in FY2024E). We expect GSPL's standalone EBITDA/PAT to post a 16%/13% CAGR over FY2023-FY2022E, given the low base of FY2023. Potential higher pipeline capex to augment pipeline capacities would result in better gas transmission tariff and support GSPL's earnings.

■ Valuation - Maintain Buy on GSPL with an unchanged SoTP -based PT of Rs. 342

Regulatory tailwinds, potential higher domestic gas production, and proximity to LNG terminals make GSPL a strong long-term bet on the robust outlook for gas demand in India. We highlight here that GSPL's core pipeline business (excluding the market value of GSPL's investment in Gujarat Gas after assuming a 20% holding company discount) is valued at just 2x its FY2025E EPS. Moreover, Gujarat state government's recent policies on dividend distribution and share buyback would improve shareholder's return in the coming years. Hence, we maintain our Buy rating on GSPL but with an unchanged SoTP-based PT of Rs. 342.

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. The company owns approximately 2,703 km natural gas pipeline and transported 25 mmscmd of gas in FY2023. To increase its geographical spread, the company had participated and won bids to put up three major pipelines outside Gujarat (1) Mallavaram (Andhra Pradesh) - Bhilwara (Rajasthan), (2) Mehsana (Gujarat) - Bhatinda (Punjab), and (3) Bhatinda (Punjab) - Srinagar (J&K). GSPL owns a stake in two city gas distribution firms – Sabarmati Gas and Gujarat Gas. The company is the second largest gas pipeline player in the country after GAIL.

Investment theme

Higher gas supplies with commissioning of new LNG terminals in Gujarat, rise in domestic gas supply, government's target to increase share of gas in India's energy mix to ~15% by 2030 (from 6% currently), and thrust to reduce pollution provide a strong gas transmission volume opportunity for GSPL. Investment in the CGD space (Gujarat Gas and Sabarmati Gas) is likely to create long-term value for investors. The core pipeline business is available at attractive valuations.

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 terms of 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: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mirae Asset Global Investments Co	7.8
2	GUJARAT MARITIME BOARD	6.57
3	Kotak Mahindra Asset Management Co	3.49
4	Norges Bank	2.78
5	GOVERNMENT PENSI	2.77
6	Gujarat Urja Vikas Nigam Ltd	2.01
7	Vanguard Group Inc/The	1.89
8	SBI Funds Management Ltd	1.87
9	Invesco Asset Management India Pvt	1.67
10	DSP Investment Managers Pvt Ltd	1.59

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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