Gujarat State Petronet Ltd

Strong Q2; core pipeline biz attractive

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Oil & Gas	Sharekhan code: GSPL
Reco/View: Buy ↔	CMP: **Rs. 279** / Price Target: **Rs. 342** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 34.32

Updated Aug 08, 2023

High Risk

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

Source: Morningstar

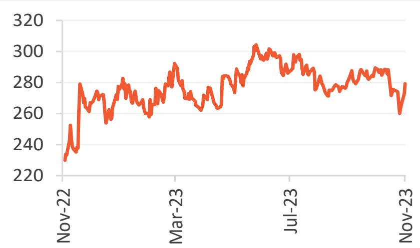
Company details

Market cap:	Rs. 15,761 cr
52-week high/low:	Rs. 311/225
NSE volume: (No of shares)	7.8 lakh
BSE code:	532702
NSE code:	GSPL
Free float: (No of shares)	35.2 cr

Shareholding (%)

Promoters	37.6
FII	16.0
DII	25.2
Others	21.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	-1.7	1.0	21.4
Relative to Sensex	-2.3	-0.3	-4.2	15.0

Sharekhan Research, Bloomberg

Summary

- Q2 PAT of Rs. 532 crore (up 132% q-o-q) was 63% above our estimate, led by higher transmission tariffs, surge in other income and lower tax rate.
- Net gas transmission tariff rose 11% q-o-q led by a better mix of HP pipelines and one-offs, while volume of 30 mmscmd missed estimate on lower volume from the refinery & petchem sector.
- PNGRB amendments to natural gas pipeline tariffs would allay concerns of steep tariff cuts of 15-20%. Recovery in capex (Rs328 crore in H1FY24 versus only Rs47 crore in H1FY23) bodes well for tariffs going forward.
- We maintain a Buy with an unchanged PT of Rs. 342 as core pipeline business is available at just 2.4x FY25E EPS.

Q2FY24 standalone operating profit of Rs. 410 crore, up 22% q-o-q was 12% above our estimate led by higher-than-expected net transmission tariff of Rs. 1.6/scm (up 11% q-o-q) and lower other expenses (36% q-o-q). Higher net gas transmission tariff was led by a better mix of HP pipelines and one-offs. However, gas transmission volume of 30 mmscmd missed our estimate of 33 mmscmd by 8%. Volume from fertilizer/power/ CGD/other sectors rose by 33%/2%/4% q-o-q to 4.6 mmscmd/4.1 mmscmd/10.8 mmscmd/5.2 mmscmd, while that from refinery & petchem sector declined by 17% q-o-q to 5.5 mmscmd. Higher net gas transmission tariff and lower operating cost led to a better-than-expected EBITDA margin of Rs. 1.5/scm (up 17% q-o-q and beat of 21% versus estimate of Rs. 1.2/scm). Standalone PAT of Rs. 532 crore (up 69% y-o-y; up 132% q-o-q) was 63% above our estimate of Rs. 326 crore due to beat in margin, significantly higher other income of Rs. 266 crore (versus Rs. 104 crore in Q2FY23) and lower tax rate of 15%.

Key positives

- Higher-than-expected transmission tariffs led to a 17% beat in EBITDA margin at Rs. 1.5/ scm.

Key negatives

- Gas transmission volume missed mark by 8% at 30 mmscmd.

Revision in estimates – We have raised our FY24-25 earnings estimate to factor higher other income and have introduced our FY26 earnings estimate.

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 (27.5 MTPA re-gas capacity) 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 market value of GSPL's investment in Gujarat Gas after assuming 20% holding company discount) is valued at just 2.4x FY2025E EPS. Moreover, the Gujarat state government's recent policies on dividend distribution and share buyback would improve shareholder returns in the coming years. Hence, we maintain a Buy with an unchanged SoTP-based price target (PT) of Rs. 342.

Key Risks

Lower-than-expected gas demand from power, fertilisers, refineries, and CGD in case of 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) Rs cr

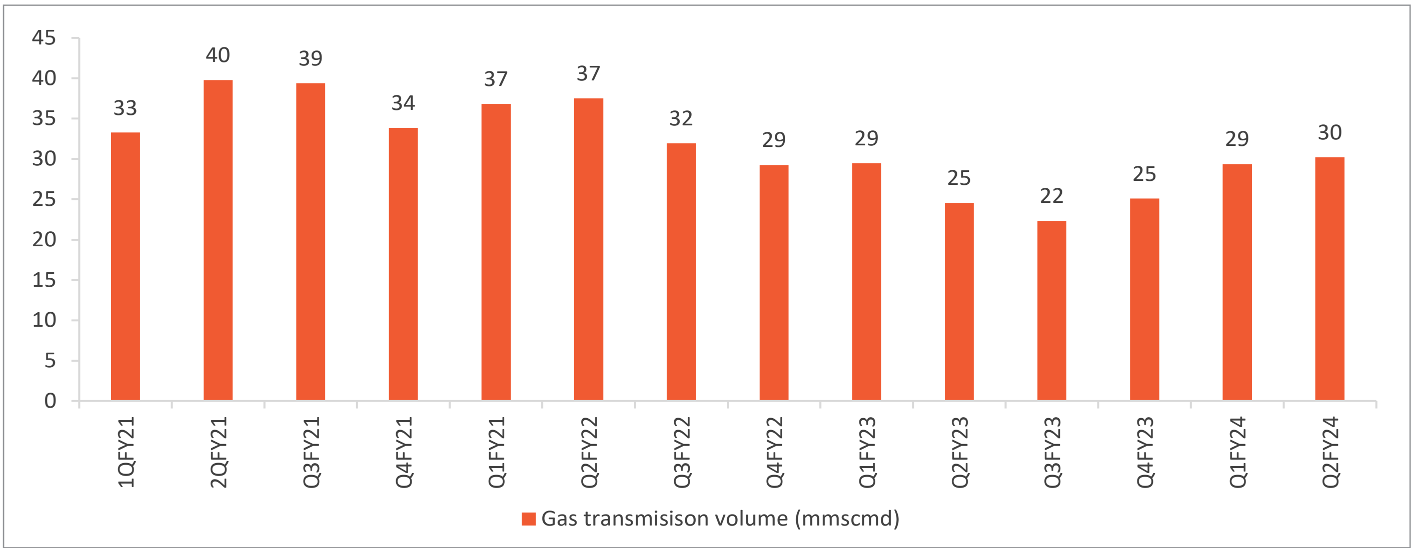
Particulars	FY22	FY23E	FY24E	FY25E	FY26E
Revenue	2,020	1,762	1,958	2,247	2,425
OPM (%)	69.2	71.4	73.1	75.4	76.1
Adjusted PAT	979	945	1,151	1,348	1,460
YoY growth (%)	5.2	-3.5	21.9	17.1	8.3
Adjusted EPS (Rs.)	17.4	16.7	20.4	23.9	25.9
P/E (x)	16.1	16.7	13.7	11.7	10.8
P/B (x)	1.9	1.7	1.5	1.4	1.2
EV/EBITDA (x)	11.3	12.0	10.8	8.5	7.2
RoNW (%)	12.2	10.7	11.8	12.4	12.1
RoCE (%)	13.8	12.0	13.6	14.4	14.8

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

Robust Q2 led by higher tariff

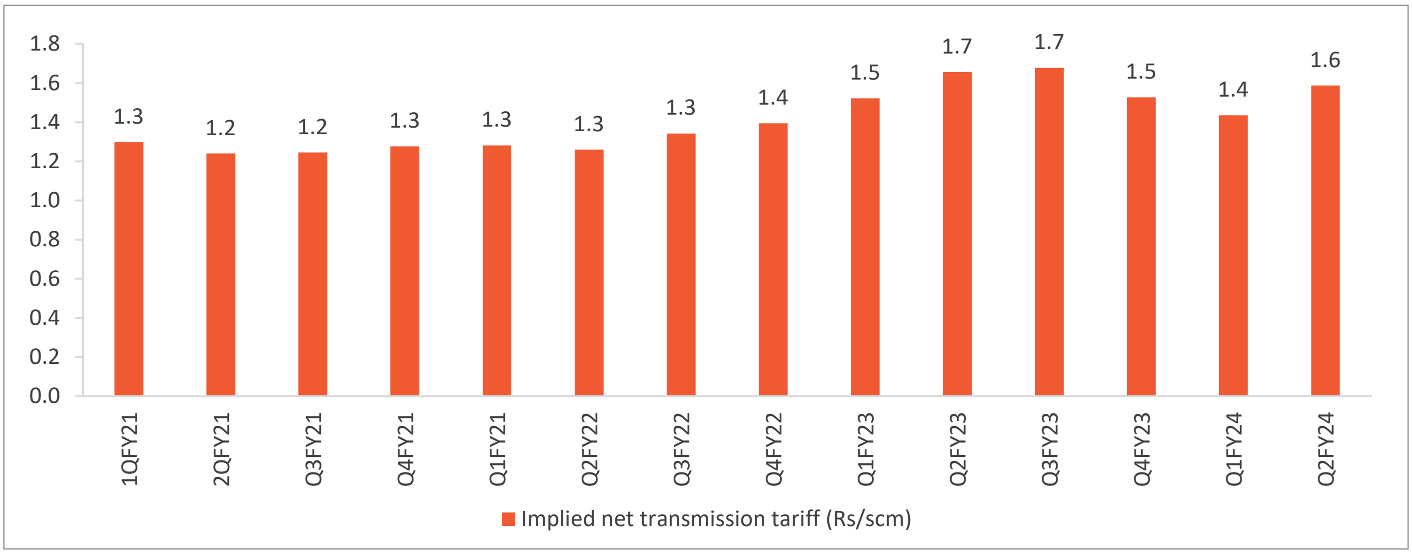
Q2FY24 standalone operating profit of Rs. 410 crore, up 22% q-o-q was 12% above our estimate led by higher-than-expected net transmission tariff of Rs. 1.6/scm (up 11% q-o-q) and lower other expenses (36% q-o-q). Higher net gas transmission tariff was led by a better mix of HP pipelines and one-offs. However, gas transmission volume of 30 mmscmd missed our estimate of 33 mmscmd by 8%. Volume from fertilizer/power/CGD/other sectors rose by 33%/2%/4% q-o-q to 4.6 mmscmd/4.1 mmscmd/10.8 mmscmd/5.2 mmscmd, while that from refinery & petchem sector declined by 17% q-o-q to 5.5 mmscmd. Higher net gas transmission tariff and lower operating cost led to a better-than-expected EBITDA margins of Rs. 1.5/scm (up 17% q-o-q and beat of 21% versus estimate of Rs. 1.2/scm). Standalone PAT of Rs. 532 crore (up 69% y-o-y; 132% q-o-q) was 63% above our estimate of Rs. 326 crore due to beat in margin, significantly higher other income of Rs. 266 crore (versus Rs. 104 crore in Q2FY23) and lower tax rate of 15%.

Volumes miss estimate



Source: Company, Sharekhan Research

Implied net gas transmission up 11% q-o-q



Source: Company, Sharekhan Research

Results (standalone) Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	**529**	**435**	**21.8**	**441**	**20.0**
Total Expenditure	119	101	18.1	105	13.7
Reported operating profit	**410**	**334**	**22.9**	**336**	**21.9**
Other Income	266	104	156.7	18	1,376.0
Interest	1	1	-10.8	1	-1.0
Depreciation	48	49	-2.2	47	1.9
PBT	628	388	62.0	307	104.8
Tax	96	73	30.4	77	23.9
Reported PAT	**532**	**314**	**69.3**	**229**	**132.0**
Equity Cap (cr)	56	56		56	
Reported EPS (Rs.)	9.4	5.6	69.3	4.1	132.0
Margins (%)			**BPS**		**BPS**
OPM	77.5	76.8	70	76.3	125
Tax rate	15.3	18.9	-369	25.2	-996
NPM	100.5	72.3	2822	52.0	4854

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Gas transportation volume (mmscm)	2,778	2,260	22.9	2,673	4.0
Gas transportation volume (mmscmd)	30.2	24.6	22.9	29.4	2.8
Implied transmission tariff (Rs. /scm)	1.9	1.9	-0.8	1.6	15.4
Net transmission tariff (Rs. /scm)	1.6	1.7	-4.2	1.4	10.6
EBITDA (Rs. /scm)	1.5	1.5	0.0	1.3	17.3

Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Infrastructure expansion, regulatory push to drive strong gas demand; volatile spot LNG price a concern**

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 power, CGD, and fertiliser sectors and 2) Regulatory push to switch to gas from polluting industrial/auto fuels. 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, volatile spot LNG (although moderated recently) and alternate fuel price would volatility in near-term volumes for gas utilities.

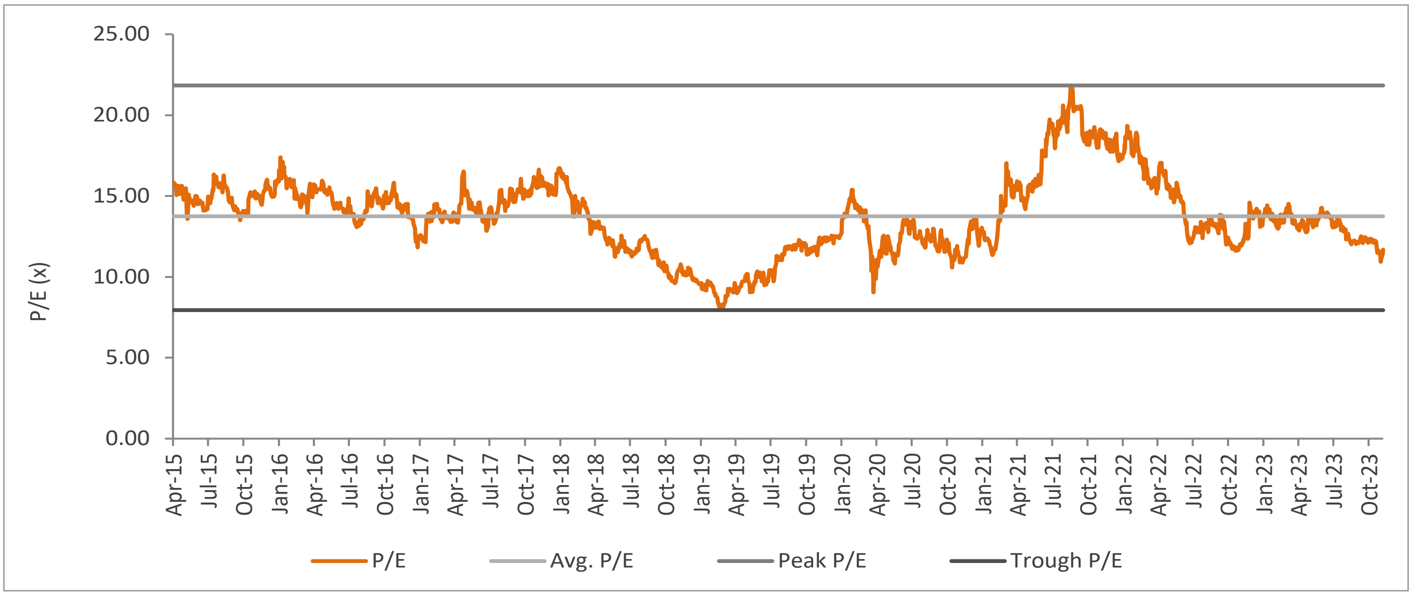
■ **Company outlook - Volume recovery to drive earnings growth**

We expect GSPL's gas transmission volume to recover in the coming quarters given the recent steep fall in the spot LNG price. We expect GSPL's gas transmission volume to rise strongly at a 16% CAGR over FY2023-FY2025E on low base of FY23 (volume decline of 25% y-o-y). The amendment in natural gas pipeline tariff regulations are positive and we model net transmission tariffs of Rs. 1.4-1.5/scm over FY2024E-2025E post expectation of 10% cut in FY24E). We expect GSPL's standalone EBITDA/PAT to post a 14%/16% CAGR over FY2023-FY2026E given low base of FY23. Potential higher pipeline capex would 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 (27.5 MTPA re-gas capacity) 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 market value of GSPL's investment in Gujarat Gas after assuming 20% holding company discount) is valued at just 2.4x FY2025E EPS. Moreover, the Gujarat state government's recent policies on dividend distribution and share buyback would improve shareholder returns in the coming years. Hence, we maintain a Buy with an unchanged SoTP-based price target (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 2,500 km natural gas pipeline, transporting 29-30 mmscmd of gas currently. 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 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, and 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 CGD space (Gujarat Gas and Sabarmati Gas) is likely to create long-term value for investors. Core pipeline business is available at attractive valuation.

Key Risks

- Lower-than-expected gas demand from power, fertiliser, and CGD in case of 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

Raj Kumar	Chairman
Ajith Kumar T R	Chief Financial Officer
Arti Kanwar	Non-Executive - Nominee Director

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	3.34
4	Norges Bank	2.78
5	GOVERNMENT PENSI	2.77
6	Gujarat Urja Vikas Nigam Ltd	2.01
7	Vanguard Group Inc/The	1.95
8	Invesco Asset Management India Pvt	1.67
9	Franklin Resources Inc	1.54
10	Gujarat Narmada Valley Fertilizers	1.42

Source: Bloomberg

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 detoriating 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

Sharekhan

by BNP PARIBAS

DISCLAIMER

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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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