BOBCAPS
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BUY
TP: Rs 370 | ⮝ 25%

GUJARAT STATE PETRONET | Oil & Gas | 22 June 2023

Discount on standalone business excessive

- **Standalone business trading at FY24E P/B of 0.4x after adjusting for GUJGA stake at market value minus 30% holding discount**
- **Multiple growth catalysts, viz. gas offtake revival in near term; connectivity to new RLNG terminals and industrial consumers in medium term**
- **High valuation discount unwarranted given return profile; we assume coverage with BUY for an SOTP-based TP of Rs 370**

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Discount on standalone business excessive: GUJS' consolidated valuation multiple (at 1.6x P/B 1Y forward) masks the implied valuation discount for its standalone transmission business (at 0.4x) after adjusting for the 54% stake in GUJGA valued at a 30% holding discount. This discount is excessive compared to the 0.7x implied by our DCF valuation of the standalone business on modest volume assumptions and given consensus estimates of 9.5-10% ROE over the next 3Y.

Investment concerns overdone: GUJS' P/B valuation mean at 0.5x over 5Y (vs. 1.1x over 10Y) reflects undue concern around its investments. The company has already repaid loans for acquiring the GUJGA stake and its CGD business has demonstrated substantial progress. On pipeline JV investments GIGL and GTIL, we factor in potential concerns over debt servicing in our valuation using a conservative volume ramp-up profile.

Growth catalysts: Near-term, we expect volume recovery to be driven by a pickup in the refining and petrochemicals businesses as well as city gas distribution. Average monthly LNG imports over Mar-May are around 50% above Jan-Feb levels. Medium-term, GUJS will be a beneficiary of increased gas penetration in Gujarat and across northern India following its connection to four key LNG terminals and expansion of LNG terminal capacity. Longer-term, its JV company GIGL will also benefit from a deeper gas network in northern and northwestern India.

Muted revenue growth in FY24E is not a negative: We expect GUJS to see a reversal of Take or Pay (TOP) benefits enjoyed in FY23 as volumes return. Factoring this in along with upcoming tariff revision, we model for 3% revenue growth against 26% volume growth in FY24. Over FY24-FY26, we pencil in a 7.4% CAGR in volumes and expect revenue/EBITDA to grow in line with volumes.

BUY, TP Rs 370: We assume coverage on GUJS with BUY and an SOTP-based TP of Rs 370. We use DCF to value the core transmission business at Rs 130/sh (WACC 11.1%, terminal growth 1%). Investments in GUJGA are valued at Rs 219 (market value), Sabarmati Gas at Rs 13 (12x FY23 P/E), GIGL at Rs 6 (0.5x FY22 P/B), GTIL at nil (pipeline stalled), and others at Re 1 after applying a 30% holding discount on all stakes.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	GUJS IN/Rs 297
Market cap	US$ 2.0bn
Free float	42%
3M ADV	US$ 2.5mn
52wk high/low	Rs 311/Rs 209
Promoter/FPI/DII	49%/17%/25%

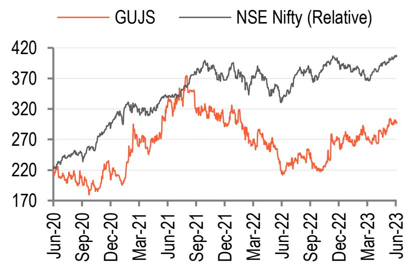
Source: NSE | Price as of 22 Jun 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	17,618	17,935	19,517
EBITDA (Rs mn)	12,587	11,798	12,653
Adj. net profit (Rs mn)	9,450	8,508	8,996
Adj. EPS (Rs)	16.7	15.1	15.9
Consensus EPS (Rs)	16.7	16.6	16.8
Adj. ROAE (%)	10.7	8.9	8.8
Adj. P/E (x)	17.7	19.7	18.6
EV/EBITDA (x)	13.7	13.9	12.6
Adj. EPS growth (%)	(3.5)	(10.0)	5.7

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



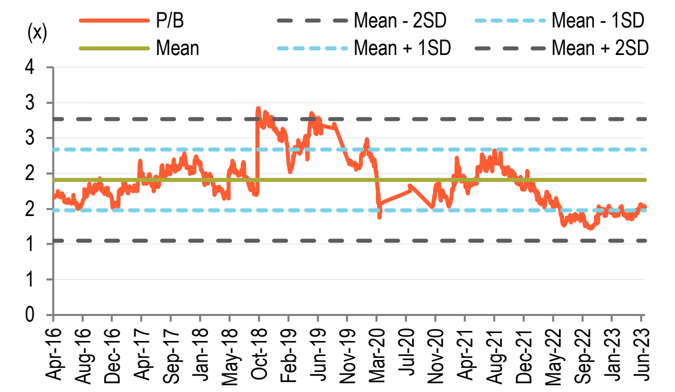
Source: NSE

Inexpensive valuation

GUJS' consolidated valuation multiples masks the implied valuation discount for its standalone transmission business.

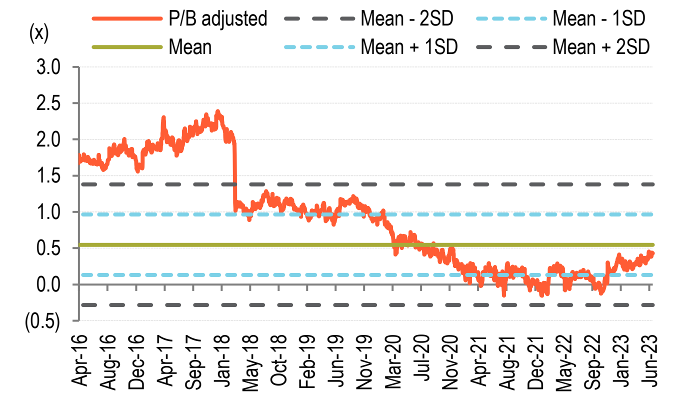
- Consolidated business is currently trading at 1.6x one-year forward P/B whereas the standalone business is at 0.4x after adjusting for the company's 54% stake in Gujarat Gas (GUJGA: valued at 30% holding discount) and implicitly according zero value to other investments including those in cross-country pipelines.

Fig 1 – P/B 1Y fwd on consolidated basis



Source: Bloomberg, BOBCAPS Research

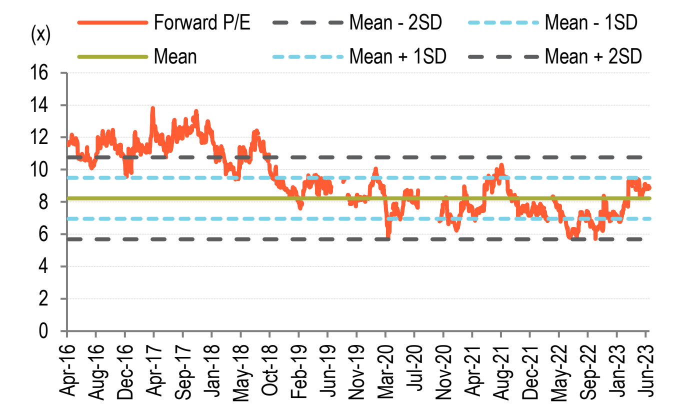
Fig 2 – P/B 1Y fwd for standalone entity adjusting for stake in Gujarat Gas



Source: Bloomberg, BOBCAPS Research

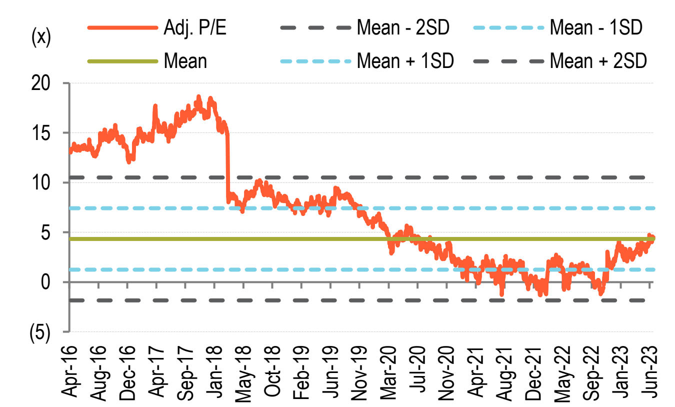
- Likewise on P/E basis, GUJS' standalone business after adjusting for the stake in GUJGA trades at an inexpensive one-year forward multiple of 4.3x against the consolidated multiple of 8.9x. Though the current valuation is in line with the five-year mean of 4.6x, it is still significantly below the ten-year mean of 8.5x.

Fig 3 – P/E 1Y fwd on consolidated basis



Source: Bloomberg, BOBCAPS Research

Fig 4 – P/E 1Y fwd for standalone entity adjusting for stake in Gujarat Gas



Source: Bloomberg, BOBCAPS Research

- The valuation discount for standalone operations is excessive considering that the business has delivered average ROE of 14% for the past five years, and consensus still expects 9.5-10% ROE over the next three years. We value the core transmission business at 0.7x FY24E P/B.

- With the recent rally, the stock appears to be reverting to its five-year mean P/B multiple of 0.5x. However, the five-year mean multiple itself is heavily discounted as compared to the ten-year mean of 1.1x. This is because GUJS saw a substantial derating after acquisition of the 54% stake in GUJGA from the latter's unlisted parent and investing in cross-country pipeline JVs, GSPL India Gasnet (GIGL) and GSPL Transco India (GTIL).
- Considering significant business progress at GUJGA and repayment of the entire loan taken for stake acquisition by FY22, we believe that the valuation discount arising from concerns over GUJS' investments is no longer justified.
- While worries over returns from cross-country pipelines still exist, we have factored the same into our valuation of investments and still find the standalone business trading at a substantial discount.

Concerns over cross-country pipelines baked in

We account for the impact of additional support for debt coverage from equity partners (IOCL, BPCL and HPCL) in our valuation of investments in GIGL and GTIL. This has been done using the DCF method carrying a discount rate of 13.1% (2% above our cost of equity assumption for GUJS) and 35 years of pipeline life.

Fig 5 – Valuation basis for pipeline investments factoring in debt coverage support from equity partners

Particulars	GIGL	GTIL
Operational assumptions		
Volume ramp-up assumptions (mmscmd)		
FY24E	4.1	2.0
FY29E	23.0	3.0
FY34E	39.1	3.0
FY39E	41.4	3.0
FY24E Tariff (Rs/mmbtu)	44.9	31.0
Debt service support		
Period of support	FY24-29	FY24-31
Impact on valuation (Rs bn)	14.8	0.5
Fair value of equity investment for 100% stake		
Value (Rs bn)	9.7	0.2
FY22 Book Value (Rs bn)	19.2	3.5
Implied P/B Multiple	0.50	0.06
FY22 P/B valuation multiple used for target price		
Before holding discount	0.50	0.00
After holding discount	0.35	0.00

Source: Company, BOBCAPS Research

Equity partners or pipeline sponsors have agreed to extend support to both pipeline companies for bearing any cost overruns and maintaining debt service coverage at 1x through the tenure.

- **Cost overrun is already partly addressed:** For the GTIL pipeline, phase-1 is complete and the JV has already written-off capex incurred on phase-2 due to its unviability. For the GIGL pipeline, lenders have agreed to fund 69% of the revised project cost of Rs 73.8bn including cost overruns of Rs 10bn, provided further cost escalation are borne by pipeline equity partners. As a majority of current known escalations have largely been addressed, we do not account for this risk explicitly in our valuation of pipeline investments.

- **Likely debt coverage support for both pipelines:** For both pipelines, we expect ramp-up of volumes to be slower than initial plan assumptions and see the need for partner support to hold debt service coverage at 1x. We have factored this risk into our valuation.

- **GIGL valued at 0.5x FY22 P/B (before holding discount):** This bakes in an impact of Rs 14.8bn in net present value terms for debt servicing support over FY24-FY29 using a conservative volume scale-up profile.

We currently assume a slow increase in transmission volumes to ~23mmscmd by FY29. Against this, we understand that GIGL has signed firm gas transmission agreements (GTA) for 9.9mmscmd of volumes, is at an advanced stage of execution for another 4.6mmscmd and has initiated discussions for another 1.6mmscmd.

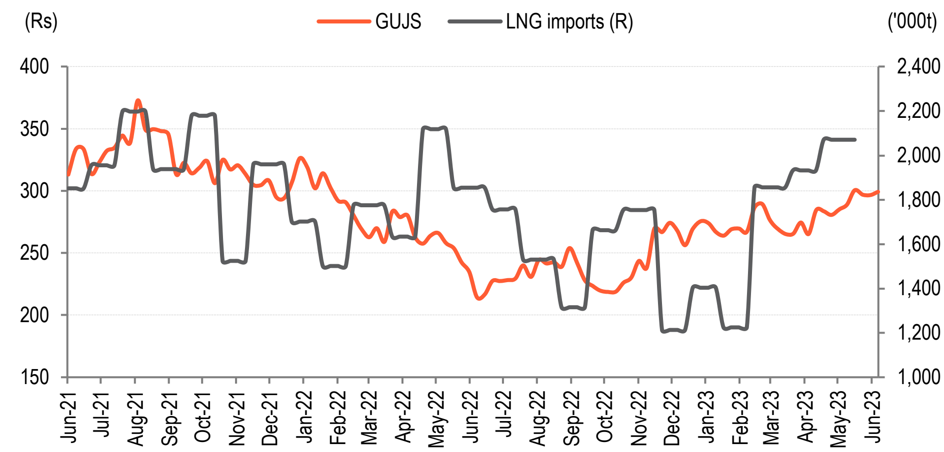
- **GTIL assigned nil value:** Factoring in debt service support over FY24-FY31, our DCF model arrives at a negligible value, treated as nil in our fair value calculation.

  We currently assume 2mmscmd of volumes for GTIL in FY24 with usage primarily for Ramagundam Fertilizers (RFCL), and build-up to 3mmscmd assuming sales to other customers in the region. Against this, GTIL is still discussing supply and transmission of another 0.3mmscmd with RFCL and has signed a framework transmission agreement with a couple of city gas distribution (CGD) players – Megha Engineering and IOCL – in the region.

Growth catalysts

An increase in transmission volumes given larger pipeline capacity coupled with expansion outside Gujarat to benefit from gas grid development across India would be key growth catalysts for GUJS. The stock price is well correlated with volume growth and GUJS' stock has risen 13% over the past two months with recovery in LNG volumes.

Fig 6 – GUJS stock up 13% over past two months with recovery in LNG volumes



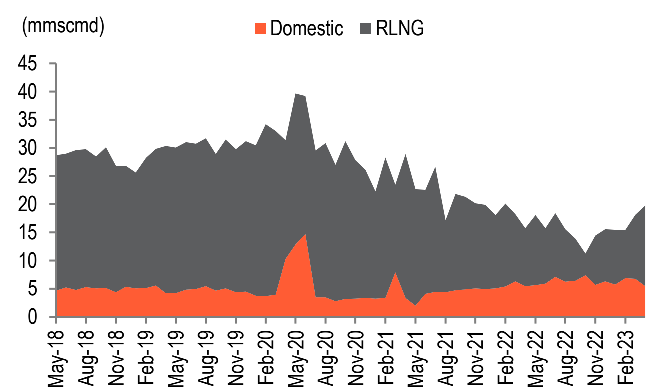
Source: Refinitiv, Bloomberg, BOBCAPS Research

Near-term: Recovery in refining, petrochem and CGD volumes

We expect near-term volume recovery to be driven by a pickup in refining and petrochemicals as well as CGD.

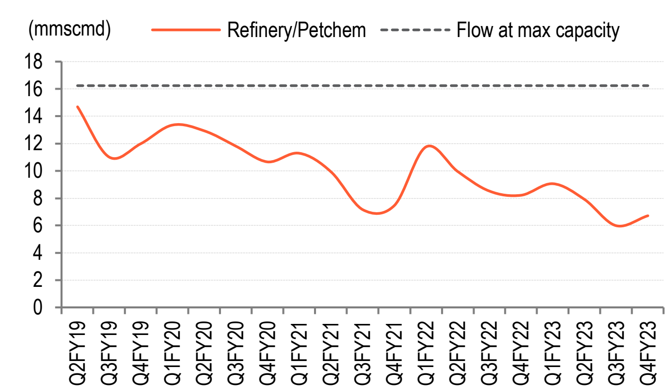
- For the CGD segment, recovery is likely to be slower than the national level as the Morbi industrial zone is facing strong competition from alternate fuel propane.
- Recovery potential for the refining, petrochem and CGD segments is visible in the large gap between maximum flow capacity declared by GUJS at 16mmscmd for refining/petrochemicals and 15mmscmd for CGD, which is well above actual volumes of 6.7mmscmd and 10mmscmd respectively in Q4FY23.
- GUJS is also likely to see a modest rise in fertiliser volumes as the KRIBHCO plant returns from maintenance shutdown.

Fig 7 – Refining and petrochemicals – India gas consumption picking up in Mar-Apr…



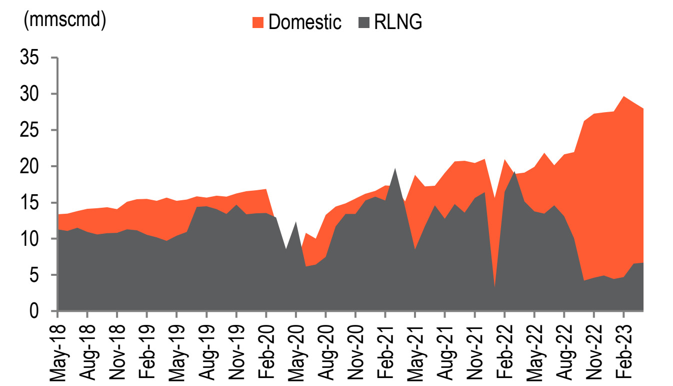
Source: PNGRB, BOBCAPS Research

Fig 8 – …GUJS could see similar trends as spot RLNG prices have eased



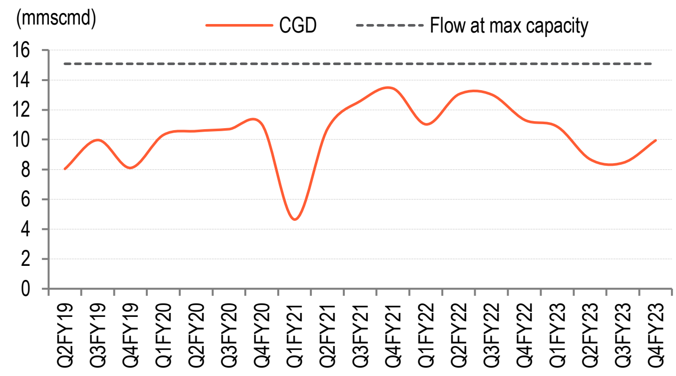
Source: Company, PNGRB, BOBCAPS Research

Fig 9 – CGD – Indian consumption has recovered with policy support…



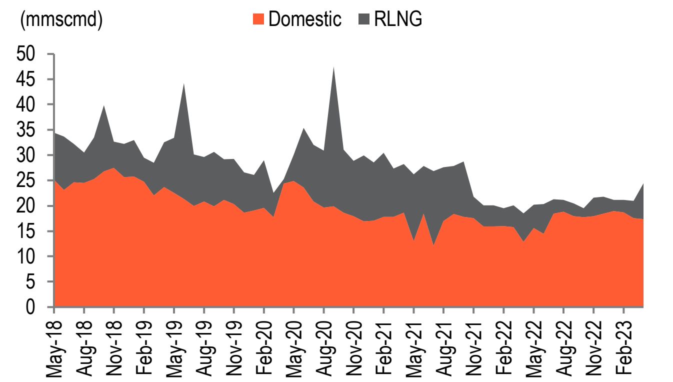
Source: PNGRB, BOBCAPS Research

Fig 10 – …but GUJS is likely to see only a modest pick-up as propane offers strong competition in Morbi



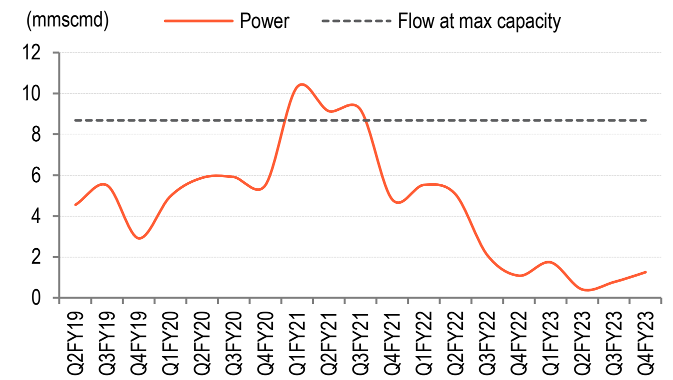
Source: Company, PNGRB, BOBCAPS Research

Fig 11 – Power – India's LNG usage remains modest with improved availability of coal…



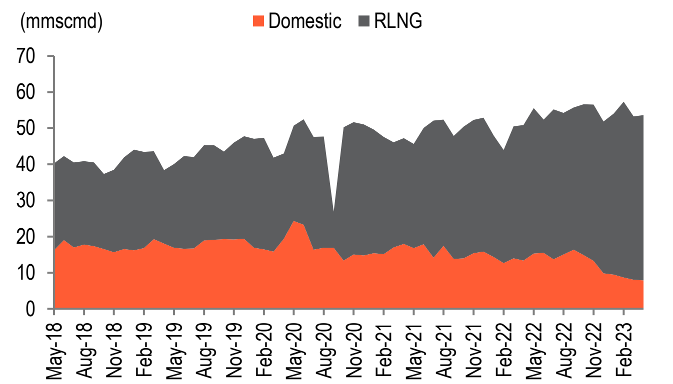
Source: PNGRB, BOBCAPS Research

Fig 12 – …GUJS unlikely to see a material recovery in power volumes near-term



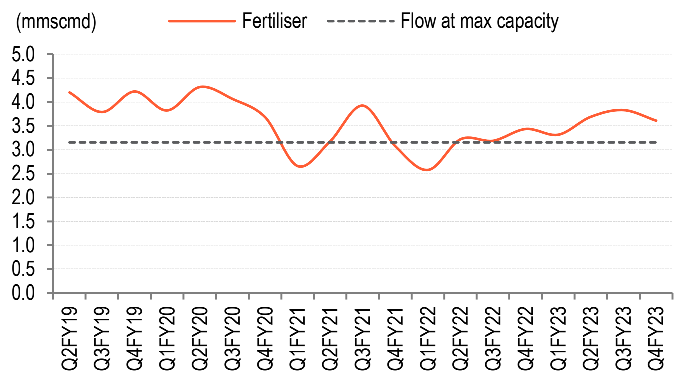
Source: Company, PNGRB, BOBCAPS Research

Fig 13 – Fertiliser – India gas consumption has been growing with ramp-up of new plants…



Source: Company, PNGRB, BOBCAPS Research

Fig 14 – …GUJS volumes to recover as KRIBHCO plant resumes after maintenance



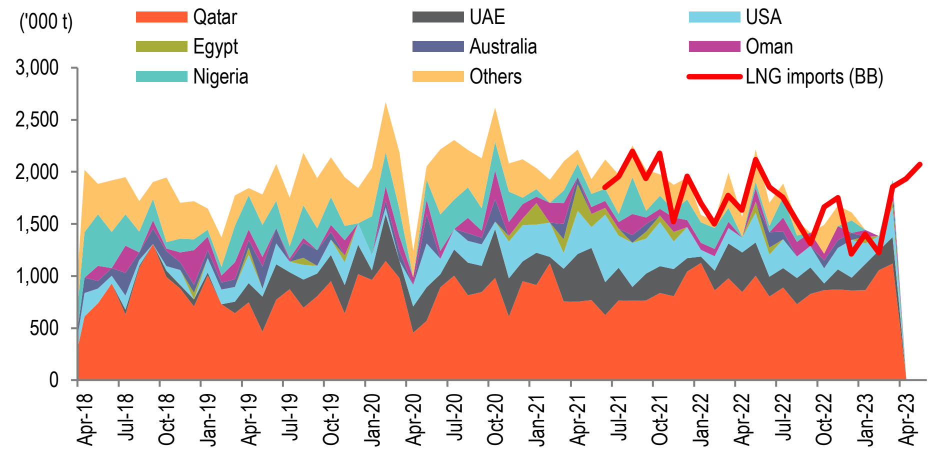
Source: Company, PNGRB, BOBCAPS Research

Signs of pickup in LNG volumes

Initial signs of volume traction are visible in LNG imports for March and April which were up ~28% over January and February. LNG imports tracked by Bloomberg also show continued strength in April-May at 1.9-2.1mt per month, up 50% above Jan-Feb levels.

PLNG, in its Q4FY23 earnings call, indicated that utilisation at its Dahej terminal has improved to 97% with the booking of 21 LNG cargoes in Apr'23, and the utilisation level reported in May also demonstrates a repeat of the same. During the monsoon season, GUJS generally benefits from increased use of the Dahej/Hazira LNG terminals which substitute for unavailability of the Konkan LNG terminal.

Fig 15 – LNG imports show initial signs of pickup in Mar-May'23



Source: Bloomberg, CMIE, BOBCAPS Research | BB: Bloomberg

Medium-term: Increased gas penetration

Connectivity to multiple LNG sources to help

GUJS is connected to multiple LNG terminals, including Petronet Dahej (17.5mmtpa plus 5mmtpa expansion planned by FY24), Shell Hazira (5mmtpa), GSPC Mundra (5mmtpa), the upcoming HPCL Chhara (5mmtpa), and the potential Swan FSRU (5mmtpa). As the next wave of global LNG terminals fructifies from FY26, LNG prices could fall below US$ 10/MMBtu, opening up the possibility of a significant increase in gas consumption in India, in turn improving utilisation at LNG terminals.

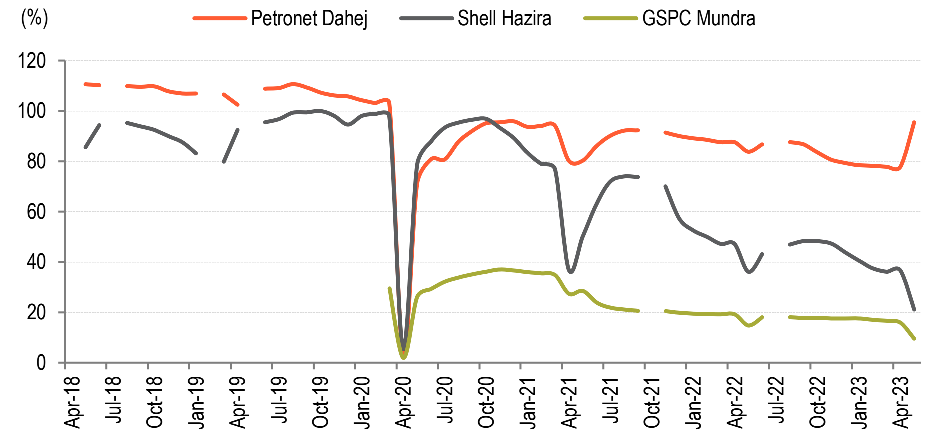
Medium-term volume growth for GUJS will be driven by volume expansion on the operational network and connectivity with new sources (i.e. Chhara LNG terminal, expansion of Dahej LNG terminal), as well as additional customers being connected (e.g. Jamnagar district as well as volume ramp-up at several CGD units in Gujarat).

Key volume growth triggers are:

- Connectivity to Chhara LNG terminal – this could enable at least 2mmscmd of volumes for consumption by HPCL group companies
- Ramp-up of volumes at several connected CGD networks of GUJGA, AdaniTotal Gas, Torrent Gas, Sabarmati Gas, and Charotar Gas within Gujarat

- Synergistic network expansion to support growth specifically targeted by GUJGA
- Scale-up of volumes on the GIGL pipeline – this is likely to drive volume growth on GUJS' Gujarat Gas Grid, particularly for sourcing regasified LNG (RLNG) from Gujarat terminals
- Higher volumes in northern and western India – this could benefit GUJS' Gujarat Gas Grid for sourcing of demand met from RLNG as most RLNG terminals are in Gujarat
- Firmer demand for several other pipeline segments under implementation

Fig 16 – Improvement in LNG terminal utilisation a medium-term driver



Source: Company, BOBCAPS Research

Project delays on some pipeline sections could dampen visibility

GUJS is facing constraints on a couple of pipeline segments, which could hinder volume growth:

- While the Anjar-Palanpur pipeline has the potential to improve gas sources for consumers on the Mehsana-Bhatinda pipeline, it is facing hurdles securing regulatory approvals. PNGRB has rejected approval for its classification as a spur line, highlighting that it has the potential to add capacity to the HP Gujarat Gas Grid.
- The timing of volume growth from the Swan LNG terminal has become somewhat uncertain as Swan Energy is attempting to deploy the FSRU (floating storage regasification unit) with Botas, Turkey, for a period of one-year.

Fig 17 – GUJS pipeline network

Particulars	Authorised capacity (mmscmd)	Authorised length (km)	Operating length (km)	Target completion date (PNGRB)[1]	Shipper/Consumers and Status of Offtake
Operational pipelines					
High-pressure Gujarat Gas Grid	31	2,207	2,638	-	Connected to RIL's East-West Pipeline, Petronet Dahej RLNG terminal, GSPC Mundra RLNG terminal and Vedanta's Barmer Field. Segment-wise customers are shown in previous section on near-term catalysts (Figs 8, 10, 12, 14)
Low-pressure Gujarat Gas Grid	12	58	57	-	Connected with Shell Hazira RLNG terminal and PMT field
Subtotal A	**43**	**2,265**	**2,695**	-	-
Tie-in connectivity under construction – Potential for volume growth in medium-term					
Jamnagar-Dwarka pipeline	3	100	-	Aug-24	To provide supply to GUJGA for catering to consumers in Jamnagar district
HPCL Chhara connectivity	18	85	-	Dec-22[2]	To enable offtake from Chhara LNG terminal at Gir, Somnath district. HPCL has completed mechanical setup of the plant in Mar'23 and is in the advanced stage of completing pipeline connectivity and the port facility by Simar Port
Expansion project for connecting new capacity at PLNG Dahej to Bhadbhut	15	39	-	Sep-22[2]	To enable offtake from the 5mtpa Dahej expansion in two phases by the end of FY24 or beginning of FY25
Tie-in connectivity under construction – Timeline for volume growth unclear					
Anjar-Palanpur	18	274	-	-	To connect GUJS HP Gujarat Gas Grid with Mehsana-Bhatinda Pipeline and also to use the capacity of the 36" Anjar-Mundra Pipeline laid in FY20. In Nov'22, PNGRB rejected GUJS' proposal to approve Anjar-Palanpur as a spur line as this would enable an increase in capacity of the HP Gas Grid
Swan Energy terminal connectivity with FSRU	18	3	-	Aug-24	To connect Gujarat Gas Grid with 10mmtpa Swan Energy (FSRU+RLNG) terminal at Jafrabad. Timeline for volume growth from this section of pipeline uncertain as Swan Energy has sought lenders' permission for deploying FSRU Vasant 1 with Botas in Turkey for a period of one year, as per its filing in Mar'23
Swan Energy terminal connectivity with RLNG	18	198	-	Dec-24	

Source: Company, PNGRB, BOBCAPS Research | [1]Natural gas pipeline status update by PNGRB as on Mar'23.[2]These target dates has not been revised by PNGRB

Long-term: Expansion beyond Gujarat

GUJS' cross-country pipeline investments in GIGL and GTIL (joint ventures with IOCL, BPCL and HPCL) were meant to tap into the gas economy outside Gujarat. While GIGL pipelines are progressing, GTIL has hit a roadblock owing to sharply lower production expectations from RIL's KG fields.

GIGL: Mehsana-Bhatinda-Gurudas pipeline Phase-2 close to completion

GIGL's pipeline volumes could improve modestly from the current ~4mmscmd as a couple of large consumers such as Guru Gobind Singh Refinery and National Fertilisers will soon be connected in Punjab. With close to 15mmscmd of GTAs signed or in the advanced stage of completion, volumes will grow gradually as consumption develops along this new pipeline route. Regulatory approval for connecting the GIGL pipeline with

Gujarat's HP Gas Grid will help bring multiple gas sources to potential customers and could encourage consumption in the area. The current status of the GIGL pipeline is as follows:

- **Phase-2 close to completion:** GIGL has operationalised 1,177km of pipeline out of 1,694km (pipeline scope revised down from the earlier length of 1,940km). Phase-1 (442km in length) was commissioned in Nov'18. For the Phase 2 pipeline length of 939km, only 5.5km of main pipeline and 37km of spur line is pending due to various right of use (RoU) issues with farmers in Punjab. GIGL is currently working on this section under police protection and aims to complete it in Jun'23. We await the latest status.

- **Modest volume ramp-up ahead:** Operational segments include Barmer-Pali-Hanumangarh and Rajasthan-Panipat, Haryana. Separately, the Amritsar-Jalandhar section is also operational. The pipeline was operating at ~4mmscmd volumes which could see modest improvement as phase-2 connects Guru Gobind Singh Refinery and National Fertilisers in Punjab. GIGL has signed firm GTAs for 9.9mmscmd of volumes, is in the advanced stage of execution for 4.6mmscmd and is in initial discussions for 1.6mmscmd.

- **Phase-3 targeted for Sep'24:** Phase-3 scope has been reduced to 312.5km from 553km. The pipeline segment under construction in phase-3 will provide connectivity for Bhatinda-Jalandhar in Punjab, Jaipur (Rajasthan)-Rewari-Faridabad in Haryana, and separately between Jalore in Gujarat and Barmer field in Rajasthan. Phase-3 commercial operations are now targeted by Sep'24. At this point, GIGL has placed the EPC order for connectivity to Rajasthan refinery and invited bids for the main line from Bhatinda to Jalandhar.

- **Connectivity to multiple sources a positive for future ramp-up:** The pipeline is connected to multiple RLNG and domestic sources and will provide significant sourcing flexibility to consumers. RLNG sources include operational terminals in Dahej, Hazira, and Munda in Gujarat, and future terminals of Swan LNG at Jafrabad and of HPCL at Chhara in Gujarat.

- **Lenders have agreed to fund this round of cost overruns:** GIGL's pipeline capex has been revised up by Rs 10bn to Rs 73.8bn factoring in cost escalations and change in scope. Lenders have agreed to fund 69% of the revised project cost up to Rs 50.8bn with a condition that further cost overruns will have to be borne entirely by project sponsors. Till Mar'23, while sponsors have infused equity of Rs 18.9bn, lenders have extended loans of Rs 37.7bn.

- At the end of FY22, GIGL had commissioned assets worth Rs 13.8bn and had another Rs 37.9bn under execution. Update for FY23 is not yet available.

GTIL pipeline has stalled

- **Limited section operational:** GTIL has connected only a 365km segment of the approved 1,811km pipeline so far. This connects the East-West pipeline to RFCL. The GTIL pipeline operated at a throughput of 1.2mmscmd in FY22.
- **Balance sections unviable:** For the balance pipeline sections of Mallavaram-Bhopal-Bhilwara-Vijaipur, GTIL has submitted to the regulator that execution is no longer financially viable given reduced gas volumes from the KG-D6 field, and has requested approval to suspend execution. IOCL has decided not to commit further equity to the JV. Recognising unviability, GTIL booked an impairment charge of Rs 1.3bn in FY22, writing down capital work in progress and intangible assets related to the balance sections of the pipeline.
- **Tariff may be slashed:** GTIL faces the risk of a significant tariff cut from the initial bid value of Rs 31/MMbtu for Zone 2 to reflect operations of just 365km against the 1,811km initially approved. The tariff is likely to be revised as and when the new configuration of the entire pipeline is finalised. However, with only partial utilisation, returns on the pipeline are likely to be below the cost of capital for the implemented section and could possibly avoid downward tariff revision.

Fig 18 – Pipeline JVs

Pipeline	Entity	Authorised capacity (mmscmd)	Authorised length (km)	Operating length (km)	Under construction length (km)	Latest extension date given by PNGRB[1]	States covered	Connectivity points
Mehsana - Bhatinda	GIGL	80	Revised to 1,694 for both sections (Previous approval was for 1,940)	1,177	763	Jun-23	Gujarat, Rajasthan, Haryana, Punjab	Barmer, Palanpur, Akarbhatta, Oda, Devli, Jaipur, Rohtak, Jind & Sonipat
Bhatinda - Gurdaspur	GIGL	42	(Previous approval was for 392)	102	290	Dec-24	Punjab and UT of Jammu & Kashmir	Jalandhar, Amritsar, Gurdaspur & Kapurthala
Mallavaram - Bhopal - Bhilwara - Vijaipur	GTIL	78	1,811	365	Not progressing	Mar-20	Andhra Pradesh, Telangana	

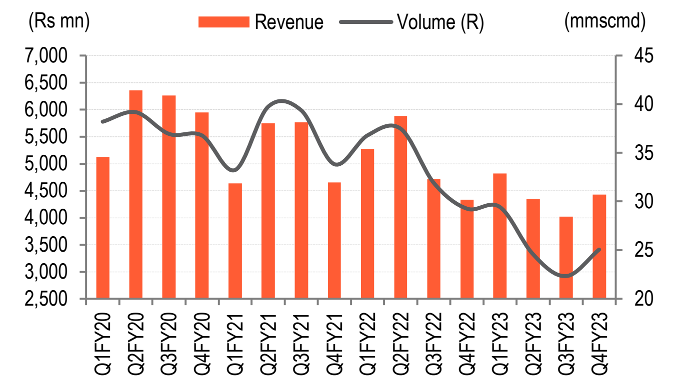
Source: Company, BOBCAPS Research | [1]Natural gas pipeline status update by PNGRB as on Dec'22

Muted FY24E revenue growth not a negative

Take or Pay benefit to reverse in FY24

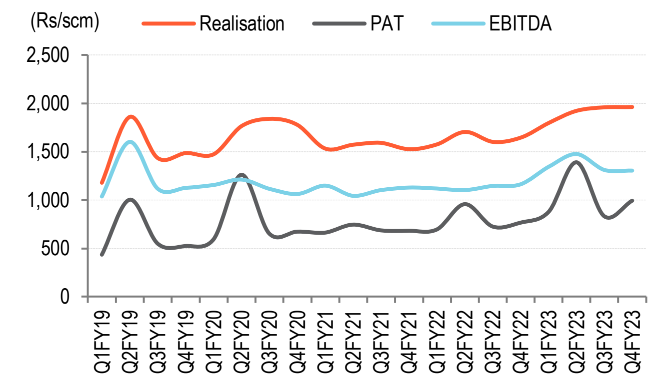
GUJS benefitted from Rs 3.7bn of Take or Pay (TOP) revenue in FY23, improving apparent unit revenue by 16% YoY to Rs 1,886/scm. This is likely to reverse in FY24 with the return of volumes, resulting in normalisation of apparent realisations as TOP revenue declines. We thus expect revenue growth to be lower than volume growth.

Fig 19 – Revenue decline was lower than fall in volumes due to benefit of TOP income…



Source: Company, BOBCAPS Research

Fig 20 – …translating to higher apparent unit revenue and profit per scm



Source: Company, BOBCAPS Research

Regulator may lower tariff from current levels

New tariff could be significantly below the ask

GUJS' tariff is under revision by the regulator. The company had submitted a proposal for revision of HP Gujarat gas grid tariff to Rs 54/MMBtu from Rs 34/MMBtu on 10 Feb 2021, and the regulator subsequently held a public consultation in Mar'22. We expect the new tariff to be significantly below the company's ask for two reasons:

- First, the proposal seems to include capex for some unapproved pipelines or pipelines without firm orders. The regulator does not normally approve capex till it is firmed up.
- Second, GUJS has assumed transmission volumes of 26mmscmd from FY21 onwards, below the actual throughput average of 35mmscmd over FY18-FY22 and below pipeline capacity of 31mmscmd.

Provisions of unified tariff to partly offset the downside

Some of the downside from a potentially downgraded tariff will be offset by favourable provisions under the nationwide unified tariff applicable across players from 1 Apr 2023, viz. (a) an elongated ramp-up period, (b) flexibility to offset higher-than-normative volumes with below-normal volumes on a cumulative basis during tariff reviews, (c) gradual annual tariff escalation, (d) permitted transmission loss or system use gas at 0.1%, and (e) no retrospective use of lower corporate tax rate for tariff determination. For details, see our note of 22 Nov 2022, **Unified gas pipeline tariff to deepen the market**.

In the absence of an approved revised tariff, Petroleum and Natural Gas Regulatory Board (PNGRB) has incorporated existing tariffs into the unified tariff as below. PNGRB has assumed tariff of Rs 34/MMbtu and volumes of 26.9mmscmd for the HP gas grid network and tariff of Rs 4/MMbtu and volumes of 8.7mmscmd for the LP gas grid. This translates into a revenue assumption of Rs 13bn for GUJS in a financial year.

Fig 21 – GUJS tariff revenue assumed in national Unified Tariff calculation

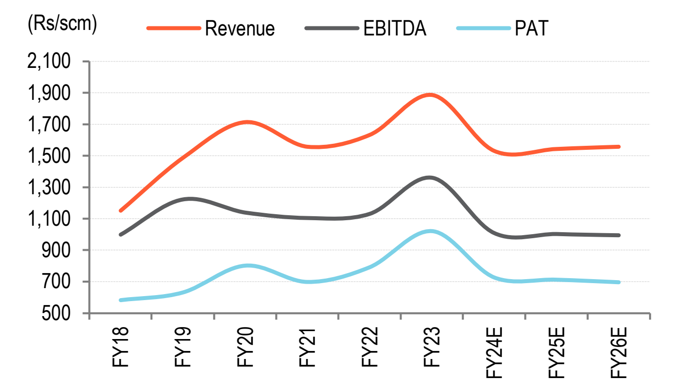
Particulars	Tariff	Zonal Volumes		Entitled revenue
	(Rs/MMbtu)	(trn btu)	(mmscmd)	(Rs mn)
GUJS HP Gas Grid				
Z1	33.15	146.5	10.6	4,857
Z2	34.84	127.7	9.3	4,449
Z3	34.86	95.6	6.9	3,331
GUJS HP Gas Grid Subtotal	**34.18**	**369.8**	**26.9**	**12,638**
GUJS LP Gas Grid				
Z1	4.08	119.1	8.7	486
GUJS Total	**26.84**	**488.9**	**35.5**	**13,124**

Source: PNGRB Supplementary Tariff Order dated 12 Apr'23, BOBCAPS Research

We build in lower apparent tariff from FY24

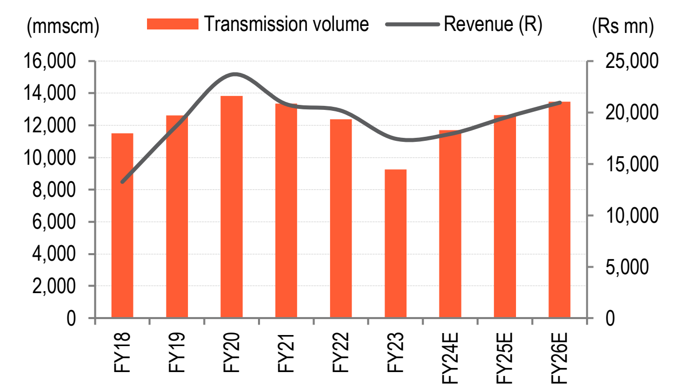
Factoring in lower TOP revenue (due to a return of volumes) and upcoming tariff revision, we assume an FY24 blended tariff of Rs 1,503/scm, down 19% YoY and closer to FY21 levels excluding material TOP benefits. As against volume growth of 26% YoY for the year, we are building in revenue growth of 3% YoY.

Fig 22 – FY24 apparent unit revenue and profit per scm to normalise with recovery in volumes



Source: Company, BOBCAPS Research

Fig 23 – FY24 revenue recovery will be lower than volume recovery as TOP revenues ebb



Source: Company, BOBCAPS Research

Improved shareholder returns

GUJS raised dividend to Rs 5/sh in FY23 (from Rs 2/sh a year ago) after the Gujarat government issued guidelines directing state public sector undertakings (PSU) to ensure minimum dividend payout at 30% of net profit or 5% of net worth. Further, while the new guidelines do not trigger buyback for GUJS based on the cash and bank balance criterion (at Rs 6.9bn as of FY23, below the minimum requirement of Rs 10bn), the company's net worth to paid-up capital ratio of 16x and net worth of Rs 93bn are both higher than the trigger points of 5x and Rs 20bn for share buyback respectively.

Key guidelines

- **Minimum dividend:** State PSUs should look to pay a minimum annual dividend of 30% of profit after tax or 5% of net worth, whichever is higher.
- **Buyback of shares:** State PSUs with a net worth of at least Rs 20bn and cash equivalent of Rs 10bn should consider buyback of shares. They should also consider buyback when the ratio of defined reserves and surplus to paid-up capital is higher than 5x. Buyback is guided as mandatory if the ratio is higher than 10x.
- **Share split:** State PSUs are directed to consider share split when the book value of shares exceeds 50 times their value, provided the existing face value of the share is more than Re 1.

Valuation methodology

Expect a 7% volume CAGR for FY24-FY26

We are factoring in a 6% YoY decline in GUJS' EBITDA for FY24 to account for downward tariff revision at Gujarat gas grid and normalisation of unit revenue as TOP income recedes with an increase in volumes. Against an estimated 26% growth in transmission volumes, we model for 3% revenue growth in FY24.

Beyond FY24, we account for revenue and EBITDA growth in line with volume growth. We currently factor in a 7.4% volume CAGR over FY24-FY26 supported by growth in Gujarat gas consumption with moderating gas prices.

Our FY26 volume forecast at 36.9mmscmd is based on close to 90% utilisation of currently declared pipeline capacity and is more conservative than the quarterly peak of 39.8mmscmd in Q2FY21 and the FY20 level of 37.8mmscmd.

While we are 4% below Refinitiv consensus on FY24 EBITDA estimates, we are 3% ahead for FY25. At this stage, consensus estimates for FY26 are thin and hence not useful for comparison.

Fig 24 – Estimates vs. Consensus

(Rs bn)	Actuals	Forecasts			Consensus			Delta to Consensus (%)		
	FY23P	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	17,458	17,925	19,507	20,973	17,195	18,663	20,118	4.2	4.5	4.3
EBITDA	12,587	11,798	12,653	13,386	12,252	12,252	12,252	(3.7)	3.3	9.3
EBITDA growth (%)	(9.9)	(6.3)	7.2	5.8	(2.7)	0.0	0.0	-	-	-
Net income	9,450	8,508	8,996	9,366	8,771	9,520	13,196	(3.0)	(5.5)	(29.0)

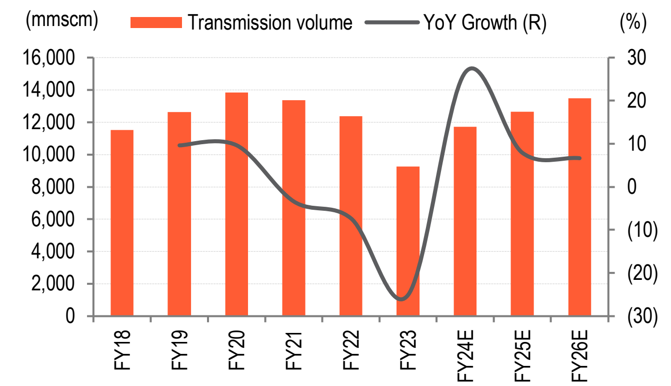
Source: Company, Refinitv, BOBCAPS Research

Fig 25 – Key assumptions

Particulars	FY23P	FY24E	FY25E	FY26E
Transmission volume (mmscmd)	25.4	32.0	34.6	36.9
Blended tariff (Rs/mscm)	1,852	1,503	1,518	1,533
EBITDA (Rs/scm)	1.4	1.0	1.0	1.0
Capex (Rs bn)	1,962	6,699	6,769	6,870
Growth				
Transmission volume (%)	(25.2)	26.2	8.2	6.6
Blended tariff (%)	15.4	(18.8)	1.0	1.0
EBITDA/scm (%)	20.3	(25.9)	(0.6)	(0.7)

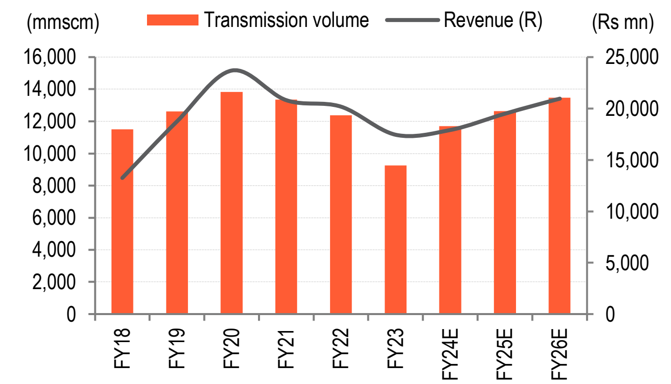
Source: Company, BOBCAPS Research

Fig 26 – Expect volume recovery in FY24E with pullback in gas prices…



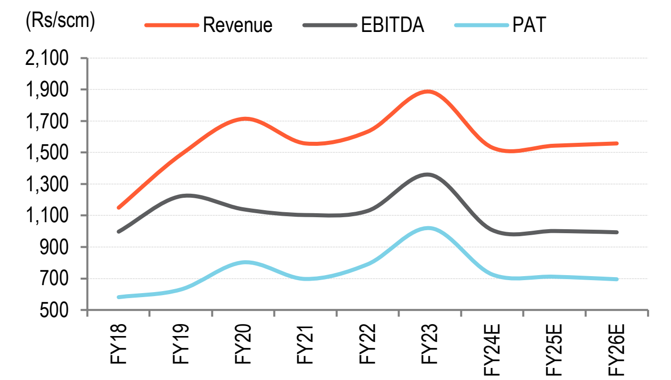
Source: Company, BOBCAPS Research

Fig 27 – …but unlikely to translate to revenue recovery as FY23 had TOP benefits



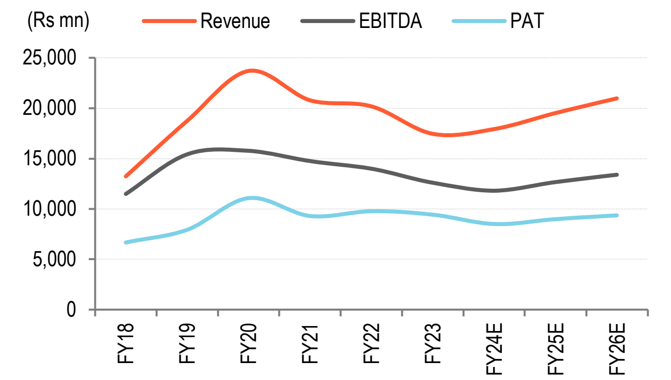
Source: Company, BOBCAPS Research

Fig 28 – FY24E unit revenue and profitability to normalise as TOP revenues come down



Source: Company, BOBCAPS Research

Fig 29 – Revenue and EBITDA to grow in line with volume growth from FY25E onwards



Source: Company, BOBCAPS Research

BUY with TP of Rs 370

We assume coverage on GUJS with a BUY rating and an SOTP-based TP of Rs 370, carrying 25% upside to the current market price. We highlight that the discount on the standalone core transmission business looks excessive with an implied FY24E P/B valuation of 0.4x vs. 0.7x implied by our DFC valuation. We believe GUJS will be a key beneficiary of a deepening of the gas economy in Gujarat, particularly as its network will soon connect to most LNG sources in western India. The company will also be able to participate in development of India's gas market through its JV investment in GIGL.

SOTP valuation

- **Core transmission business:** We value the core business at Rs 130/sh using the DCF method, assuming WACC of 11.1%, an explicit and semi-explicit forecast period of 10 years, 4% growth in operational cash flow over the fade period, and terminal growth of 1% thereafter.
- **Investments:** We value investments applying a holding company discount of 30%.
  - **Investments in CGD:** While the stake in GUJGA is assessed at Rs 219/sh based on market price, we ascribe the Sabarmati Gas holding a trailing P/E multiple of 12x on a conservative basis for a value of Rs 13/sh.

- **Investment in pipelines:** For the stakes in cross-country pipeline JVs, we use a trailing P/B multiple given regulated returns. While we value GIGL at Rs 6/sh using an FY22 P/B multiple of 0.5x given a long ramp-up period ahead, we do not factor in any value for GTIL at this stage due to the regulatory overhang on tariffs and potential penalty for the incomplete pipeline sections. Our DCF model for these two pipelines also confirms these multiples after accounting for the impact of additional support for debt service coverage (Fig 5 has details).
- **Other investments:** We value other investments in GSPC LNG, Gujarat State Energy Generation and Swan LNG at book value.

Fig 30 – Valuation summary

Valuation parameters	Value (Rs bn)	Value per share (Rs)	Valuation approach
GUJS Core Transmission			DCF, WACC of 11.1%, Terminal growth of 1%
PV of FCF FY24E-FY33E	28.6	-	
PV of terminal value	30.4	-	
Enterprise value	59.0	-	
Net debt FY23E	(6.9)	-	
Fair equity value Mar'23	65.9	-	
Fair equity value Mar'24	**73.2**	**130**	**Implied P/B multiple of 0.7x**
Value of investments			
Gujarat Gas (54.17% stake)	123.4	219	Market price, 30% holding discount
Sabarmati Gas (27.47% stake)	7.4	13	Trailing P/E of 12x, 30% holding discount
GIGL (52% stake)	3.5	6	Trailing P/B of 0.5x, 30% holding discount. Factors in potential debt-service support as confirmed by our DCF approach
GTIL (52% stake)	0.0	0	Trailing P/B of 0x, 30% holding discount. Factors in potential debt-service support as confirmed by our DCF approach
Other investments	0.6	1	Trailing P/B of 1x, 30% holding discount
Fair equity value of investments	**134.9**	**239**	
Fair value GUJS	**200.8**	**369**	
Target price rounded to nearest Rs 5	**-**	**370**	

Source: BOBCAPS Research

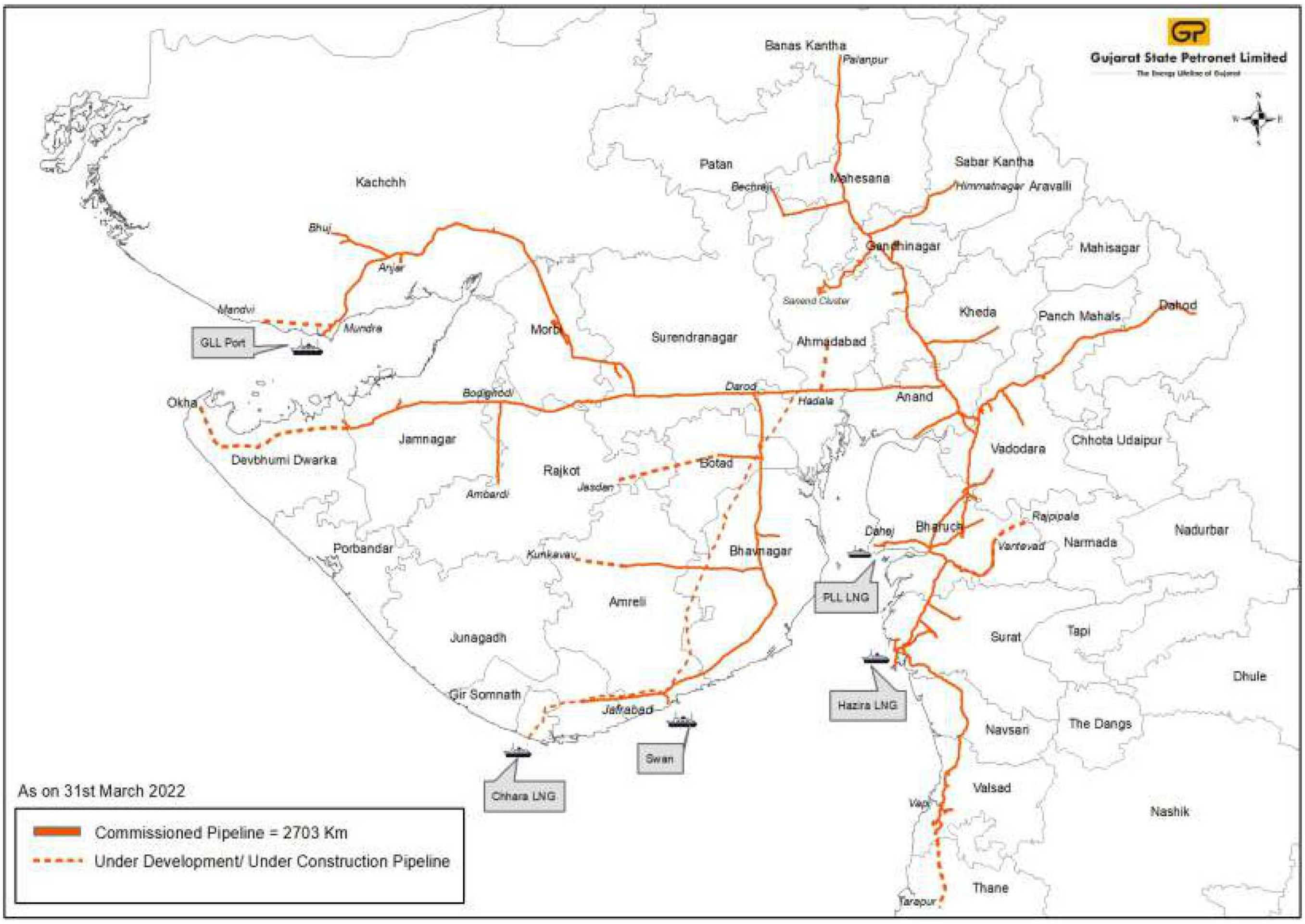
Key risks

Key downside risks to our estimates are:

- **Regulations:** GUJS' pipeline tariffs are regulated by PNGRB. Any reduction in tariffs on account of a change in guidelines could severely hit earnings.
- **Below-expected volume growth:** Slower recovery in transmission volumes than our current assumptions could impact revenues and returns for GUJS. The company is also exposed to delays in obtaining regulatory clearances for new pipelines.
- **Above-expected debt coverage support for two JV pipelines:** Slower volume ramp-up than our current assumptions could result in higher support for debt service coverage from project sponsors.
- **Penalty on GTIL:** PNGRB is yet to finalise the penalty for non-completion of the GTIL pipeline, which is no longer financially viable. At this stage, we do not incorporate any value for GUJS' investment in GTIL.

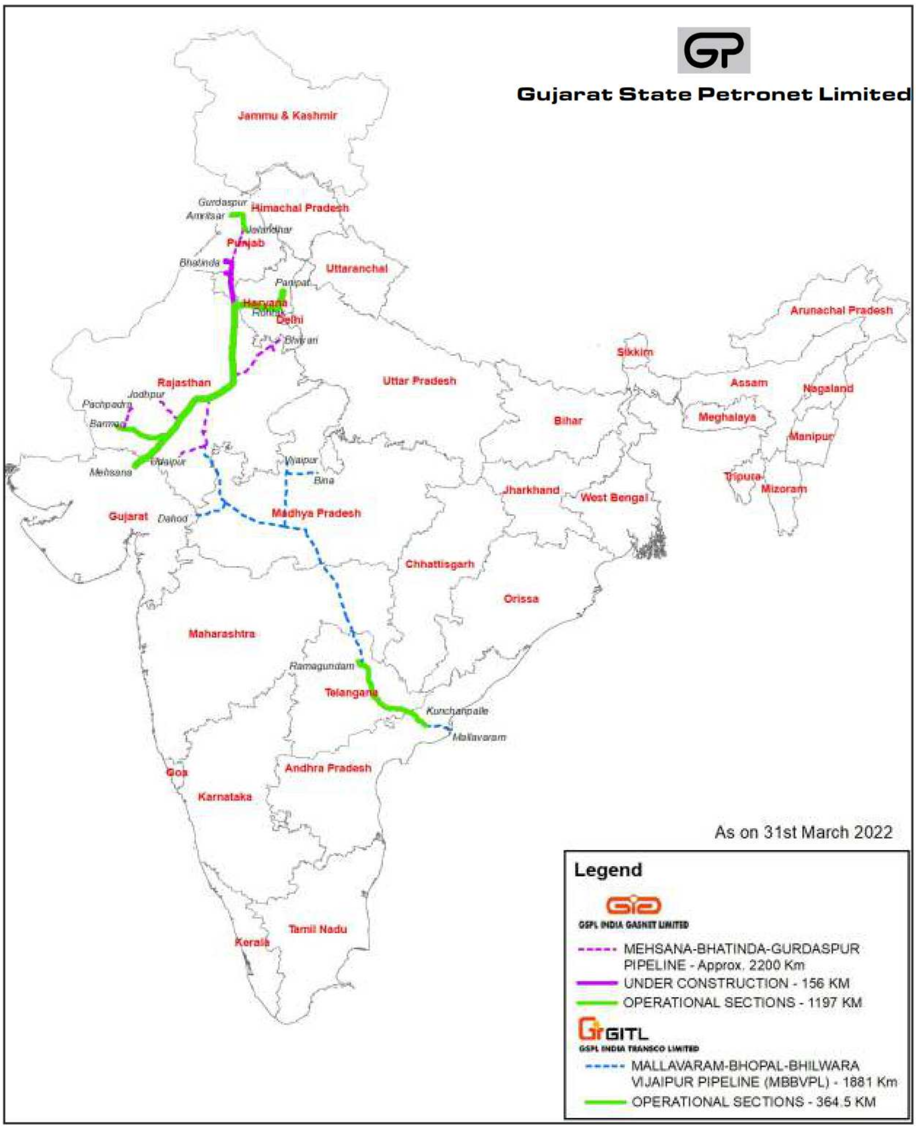
Annexure A

Fig 31 – GUJS gas grid map



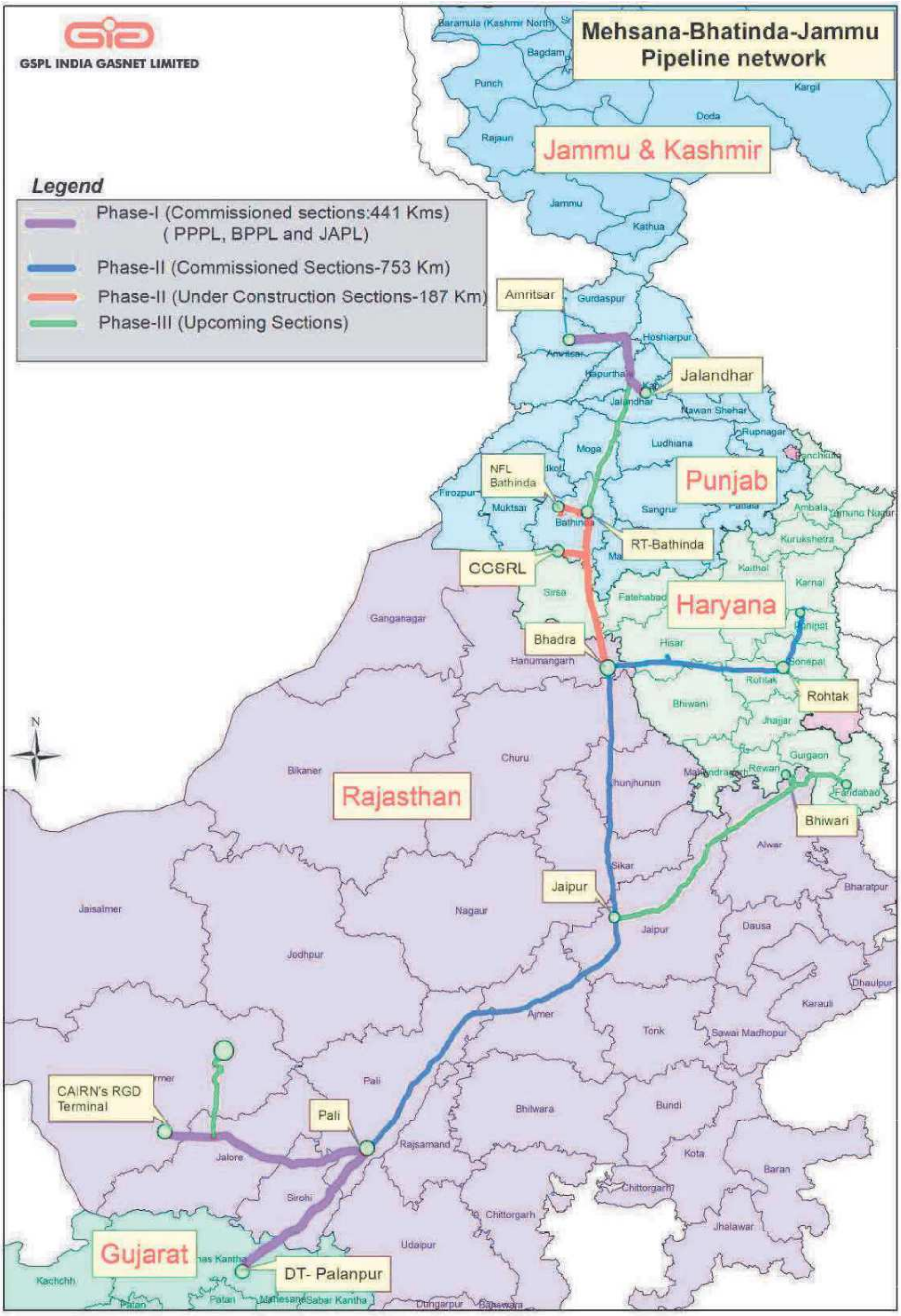
Source: Company

Fig 32 – GIGL/GTIL: Cross-country pipelines under implementation



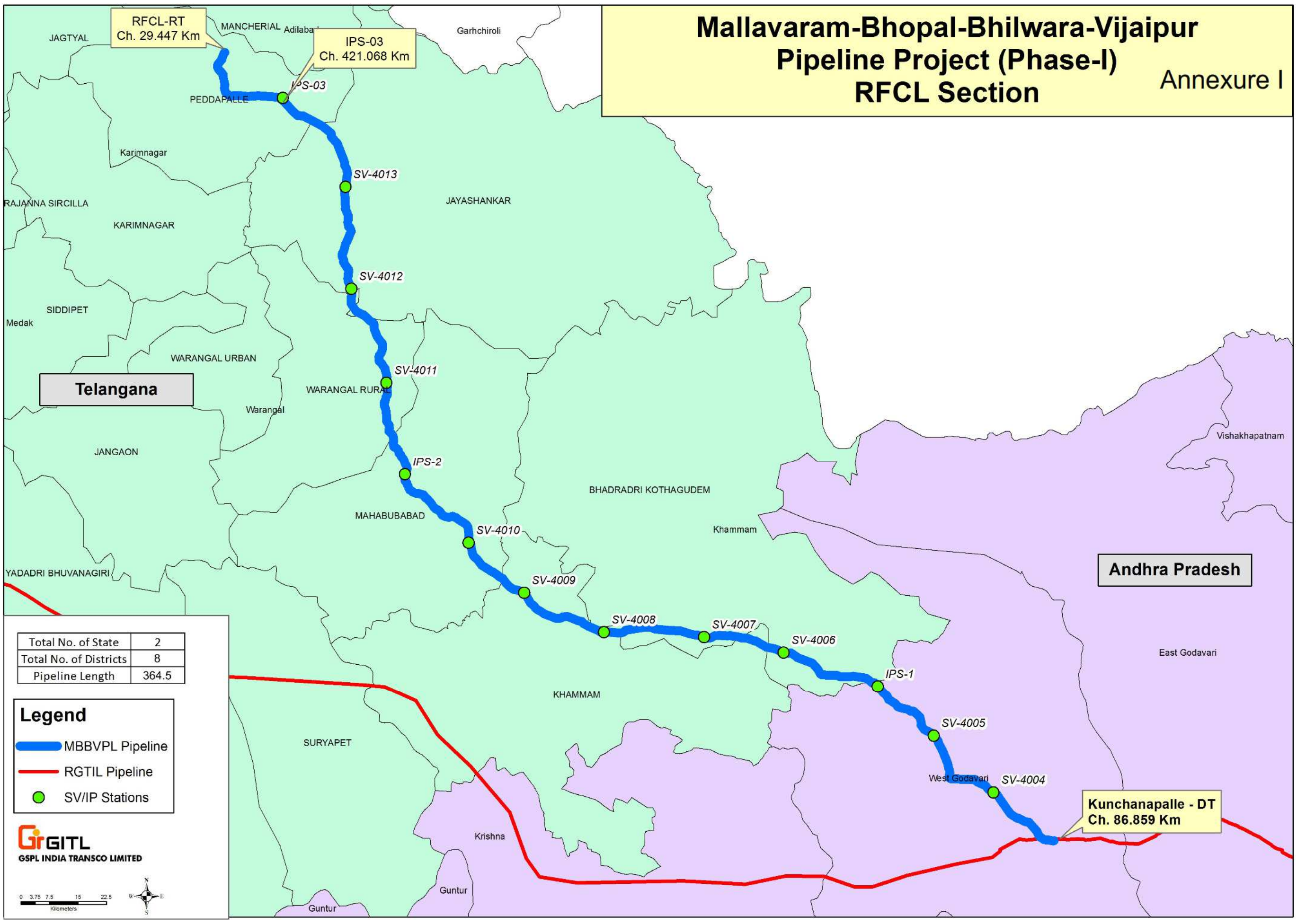
Source: Company

Fig 33 – GIGL pipeline: Detailed map



Source: Company

Fig 34 – GTIL – MBBVPL (Phase-1) pipeline



Source: Company

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Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Total revenue	**20,200**	**17,618**	**17,935**	**19,517**	**20,983**
EBITDA	13,976	12,587	11,798	12,653	13,386
Depreciation	(1,960)	(1,939)	(2,054)	(2,294)	(2,579)
EBIT	12,016	10,648	9,744	10,359	10,807
Net interest inc./(exp.)	(313)	(47)	0	0	0
Other inc./(exp.)	1,045	1,684	1,630	1,668	1,715
Exceptional items	0	0	0	0	0
EBT	12,748	12,286	11,374	12,027	12,522
Income taxes	(2,958)	(2,836)	(2,866)	(3,031)	(3,155)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	**9,791**	**9,450**	**8,508**	**8,996**	**9,366**
Adjustments	0	0	0	0	0
Adjusted net profit	**9,791**	**9,450**	**8,508**	**8,996**	**9,366**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Accounts payables	654	510	519	565	607
Other current liabilities	1,844	1,914	1,914	1,914	1,914
Provisions	262	262	262	262	262
Debt funds	877	0	0	0	0
Other liabilities	5,334	5,465	5,477	5,490	5,504
Equity capital	5,642	5,642	5,642	5,642	5,642
Reserves & surplus	78,787	87,090	93,045	99,342	1,05,899
Shareholders' fund	84,429	92,732	98,687	1,04,984	1,11,541
Total liab. and equities	**93,400**	**1,00,883**	**1,06,860**	**1,13,216**	**1,19,828**
Cash and cash eq.	864	6,917	8,201	9,649	11,569
Accounts receivables	1,295	1,440	1,447	1,577	1,698
Inventories	1,890	2,121	2,170	2,365	2,546
Other current assets	1,828	2,896	2,851	2,960	3,060
Investments	51,737	51,700	51,737	51,737	51,737
Net fixed assets	33,255	31,552	34,174	38,620	42,871
CWIP	2,531	4,257	6,279	6,308	6,348
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**93,400**	**1,00,883**	**1,06,860**	**1,13,216**	**1,19,828**

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Cash flow from operations	**11,648**	**8,318**	**8,942**	**9,247**	**9,885**
Capital expenditures	(864)	(1,962)	(6,699)	(6,769)	(6,870)
Change in investments	(1,675)	37	(37)	0	0
Other investing cash flows	1,072	1,684	1,630	1,668	1,715
Cash flow from investing	**(1,467)**	**(241)**	**(5,106)**	**(5,101)**	**(5,155)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(9,383)	(877)	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(1,128)	(1,128)	(2,552)	(2,699)	(2,810)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	**(10,511)**	**(2,006)**	**(2,552)**	**(2,699)**	**(2,810)**
Chg in cash & cash eq.	**(330)**	**6,071**	**1,284**	**1,448**	**1,920**
Closing cash & cash eq.	**547**	**6,935**	**8,201**	**9,649**	**11,569**

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23P	FY24E	FY25E	FY26E
Reported EPS	17.4	16.7	15.1	15.9	16.6
Adjusted EPS	17.4	16.7	15.1	15.9	16.6
Dividend per share	2.0	2.0	4.5	4.8	5.0
Book value per share	149.6	164.4	174.9	186.1	197.7

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23P	FY24E	FY25E	FY26E
EV/Sales	8.6	9.8	9.1	8.2	7.5
EV/EBITDA	12.5	13.7	13.9	12.6	11.8
Adjusted P/E	17.1	17.7	19.7	18.6	17.9
P/BV	2.0	1.8	1.7	1.6	1.5

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23P	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	76.8	76.9	74.8	74.8	74.8
Interest burden (PBT/EBIT)	106.1	115.4	116.7	116.1	115.9
EBIT margin (EBIT/Revenue)	59.5	60.4	54.3	53.1	51.5
Asset turnover (Rev./Avg TA)	21.6	18.1	17.3	17.7	18.0
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.1	1.1
Adjusted ROAE	12.2	10.7	8.9	8.8	8.7

Ratio Analysis

Y/E 31 Mar	FY22A	FY23P	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	(2.9)	(12.8)	1.8	8.8	7.5
EBITDA	(5.1)	(9.9)	(6.3)	7.2	5.8
Adjusted EPS	5.2	(3.5)	(10.0)	5.7	4.1
Profitability & Return ratios (%)					
EBITDA margin	69.2	71.4	65.8	64.8	63.8
EBIT margin	59.5	60.4	54.3	53.1	51.5
Adjusted profit margin	48.5	53.6	47.4	46.1	44.6
Adjusted ROAE	12.2	10.7	8.9	8.8	8.7
ROCE	10.8	9.2	7.6	7.6	7.5
Working capital days (days)					
Receivables	26	28	29	28	28
Inventory	161	293	230	214	207
Payables	37	42	31	29	28
Ratios (x)					
Gross asset turnover	0.4	0.4	0.4	0.4	0.3
Current ratio	1.6	5.0	5.4	6.0	6.8
Net interest coverage ratio	38.4	227.5	0.0	0.0	0.0
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

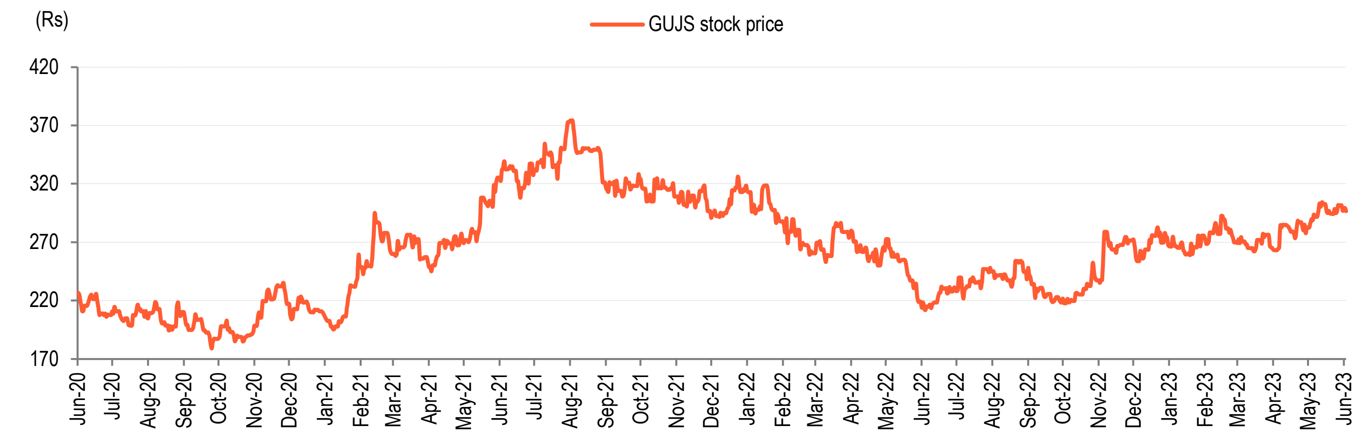
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): GUJARAT STATE PETRONET (GUJS IN)



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