AXIS DIRECT

31 MAY 2017 | Company Update

GAIL INDIA

OIL & GAS

HOLD

Target Price: Rs 400

US LNG: Volume risk out; pricing risk in

GAIL has placedits entire US LNG volumes of 5.8 mntpa in domestic (4.6 mntpa) and international (1.5 mntpa) markets. GAIL aims to supply ~2.9 mntpa US LNG (HH linked, landed price at USD 10/mnbtu) to domestic users on oil linkage basis (delivered cost at USD 8-8.5/mnbtu). **We see this as a major risk,** as different contract terms (buying at HH linkage and selling at oil linkage) exposes GAIL to pricing risk, and could lead to trading loss of ~Rs 14 bn (17% of FY19 EBITDA). Also, lack of take-or-pay terms with gas users (if any) may pose risk to volume.

GAIL is now an oil play; maintain HOLD: Higher oil price will benefit GAIL as its US LNG contracts will become competitive to oil-linked gas contracts at Brent price of USD 63/bl. Profitability of GAIL's petchem, LPG and Liquid Hydrocarbon segments will also get propped. We roll over to FY19 with TP of Rs400 (Rs 379 earlier).

CMP	: Rs 381
Potential Upside	: 5%

MARKET DATA

No. of Shares	: 1,691mn
Free Float	: 46%
Market Cap	: Rs643bn
52-week High / Low	: Rs434 / Rs269
Avg. Daily vol. (6mth)	: 4.2 mn shares
Bloomberg Code	: GAIL IB Equity
Promoters Holding	: 54%
FII / DII	: 15% / 24%

Other negatives: Higher capex and delay in tariff notification

- GAILhas targeted capex at Rs 43/77 bn in FY18/19. Major capex would be in its Jagdishpur-Haldia&Bokaro-Dhamrapipeline (project cost at Rs 130 bn), which not benefit earnings before FY20, and is RoCE dilutive
- Lack of quorum at PNGRB# may lead to further delay in notification of tariffs for GAIL's key pipelines (~75% of volumes). Note tariffs needs to be notified before Sep '17 to be effective in FY18

Cut FY18Eand FY19E EPS by 10% and 7%

We buildin (a) higher employee costs as the 3rdPay Revision Committee report will increase GAIL's employee costs by Rs 4 bn (vs. FY17 staff cost of Rs 12.5 bn), and (b) delay in tariff notification beyond Sep '17, hence tariff hike of 8% available only in FY19.At CMP, the stock trades at 13x FY19E EPS of Rs29 (Rs 31 earlier).

Risk to our call: (a) GAIL has challenged PNGRB's tariff calculation methodology in Delhi High Court. The hearing has been completed and final decision may be announced in due course. Favorable judgment for GAIL will be positive

Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	517,213	481,489	483,169	531,447
Adj PAT (Rs mn)	22,264	38,016	46,159	49,257
Con. EPS* (Rs)	-	-	31.0	30.7
EPS (Rs)	13.2	22.5	27.3	29.1
Change YOY (%)	(25.2)	70.8	21.4	6.7
P/E (x)	28.9	16.9	13.9	13.1
RoE (%)	6.9	10.4	11.8	11.9
RoCE (%)	8.7	13.3	14.6	14.7
EV/E (x)	16.2	10.5	9.1	8.8
DPS (Rs)	4.1	9.1	12.3	13.1

Source: *Consensus broker estimates, Company, Axis Capital
#:Petroleum & Natural Gas Regulatory Board

Key drivers

(Rs/scm)	FY17	FY18E	FY19E
Gas vol (mmscmd)	100	104	108
Tariffs (Rs/mscm)	1,262	1,262	1,363
Spot mktgmgn	0.41	0.50	0.50

Price performance

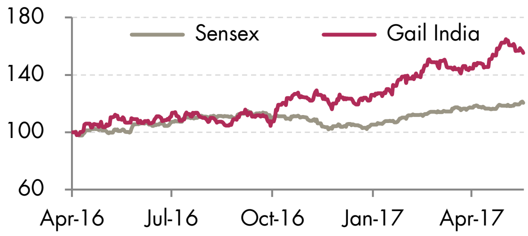

Exhibit 1: GAIL – Status on tie-ups for US LNG contracts

(mntn)	Conract	CY18	CY19	CY20	Remarks
US LNG volumes		4.0	5.8	5.8	
Gas user tie-ups					
Outside India					
- Long-term (Shell)	Firm	0.6	0.6	0.6	25-year contract
- Swap (Gunvor)	Firm	0.6	0.6	0.6	GAIL to supply 0.6 mntn to Gunvor on US FoB; and Gunvor to supply 0.8 mntn to GAIL (12% oil linkage). Contract to be renegotiated in CY19/20
- Short-term (Others)	Firm	0.3	0.3	0.3	Contract to be renegotiated in CY19/20
Volume tied-up (B)		1.5	1.5	1.5	
Within India					
- New LT contracts	Firm	2.9	2.9	2.9	GAIL has converted ~75% of its spot LNG customers (~3.8 mntn) to long-term contracts (predominantly oil linked)
- Ratnagiri Gas	Firm	0.5	0.5	0.5	5-year contract. RGPPL has signed PPA with Railways at Rs 5.4/unit tariff
- 5 fertilizer plants	Potential	-	1.2	3.0	2 plants in Dec '18; Revival of 3 sick units in 2020
Volume tied-up (C)		3.4	4.6	6.4	
Total volume tied-up (D=B+C)		4.9	6.1	7.9	
Open volumes (A-D)		(0.9)	(0.3)	(2.1)	

Source: Axis Capital, Company

Exhibit 2: Pricing comparison – HH linkage vs. domestic oil linked contracts

(USD /mmbtu)	Oil linked contracts				US-HH
Brent (USD/bl) >>	40	50	60	65	
Henry Hub price					3.3
115% of Henry hub					3.8
Capacity charge					3.0
FOB	5.1	6.3	7.6	8.2	6.8
Shipping	0.5	0.5	0.5	0.5	2.0
Delivered cost (DES)	5.6	6.8	8.1	8.7	8.8
Import duty @ 2.5%	0.1	0.2	0.2	0.2	0.2
Liquifaction charge	0.7	0.7	0.7	0.7	0.7
Price (ex-terminal)	6.4	7.7	9.0	9.7	9.7

Source: Axis Capital, Company; oil linkage assumed at 12.5%

Exhibit 3: GAIL - SoTP

	Valuation base		Multiple (x)		Enterprise Value	
	Matrix	Value	Multiple	Value (x)	(Rsbn)	(Rs/sh)
Transmission business						
NG Transmission	EBITDA (Rsmn)	37,904	EV/EBITDA	7.0	265	157
LPG Transmission	EBITDA (Rsmn)	3,100	EV/EBITDA	7.0	22	13
Total (a)					**287**	**170**
Other business segments						
Gas Trading	EBITDA (Rsmn)	12,924	EV/EBITDA	4.0	52	31
Petrochemical	EBITDA (Rsmn)	20,921	EV/EBITDA	6.0	126	74
LPG and Liquid HC	EBITDA (Rsmn)	13,131	EV/EBITDA	6.0	79	47
Total (b)					**256**	**151**
Investments						
ONGC	Shares ('000)	308,402	CMP (10% disc.)	175	48	29
IGL	Shares ('000)	31,500	CMP (10% disc.)	985	28	17
PLNG	Shares ('000)	93,750	CMP (10% disc.)	426	36	21
MGL	Shares ('000)	32,103	CMP (10% disc.)	952	28	16
Other Investments	Book Value (Rsmn)	37,675	P/BV	1.00	38	22
Total (c)					**177**	**105**
Total Enterprise Value (a+b+c)					**720**	**426**
Less: Net debt					41	24
Total Equity Value					**679**	**402**

Source: Axis Capital

Financial summary (Standalone)

Profit &loss (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	517,213	481,489	483,169	531,447
Other operating income	-	-	-	-
Total operating income	**517,213**	**481,489**	**483,169**	**531,447**
Cost of goods sold	(422,074)	(363,932)	(351,566)	(389,494)
Gross profit	95,139	117,557	131,603	141,953
Gross margin (%)	*18.4*	*24.4*	*27.2*	*26.7*
Total operating expenses	(52,338)	(53,462)	(56,398)	(60,118)
EBITDA	**42,801**	**64,094**	**75,205**	**81,834**
EBITDA margin (%)	*8.3*	*13.3*	*15.6*	*15.4*
Depreciation	(13,098)	(13,968)	(15,392)	(15,392)
EBIT	**29,703**	**50,126**	**59,813**	**66,442**
Net interest	(7,999)	(4,794)	(5,634)	(8,156)
Other income	8,916	11,763	11,763	12,081
Profit before tax	**30,620**	**57,095**	**65,942**	**70,367**
Total taxation	(8,355)	(19,079)	(19,782)	(21,110)
Tax rate (%)	*27.3*	*33.4*	*30.0*	*30.0*
Profit after tax	22,264	38,016	46,159	49,257
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	22,264	38,016	46,159	49,257
Adj. PAT margin (%)	*4.3*	*7.9*	*9.6*	*9.3*
Net non-recurring items	-	(2,987)	-	-
Reported net profit	22,264	35,029	46,159	49,257

Balance sheet (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	12,685	16,913	16,913	16,913
Reserves & surplus	338,261	364,581	386,331	409,541
Net worth	350,946	381,494	403,244	426,454
Borrowing	68,466	42,774	57,774	87,774
Other non-current liabilities	40,471	46,559	46,559	46,559
Total liabilities	**459,882**	**470,827**	**507,577**	**560,787**
Gross fixed assets	478,262	486,439	488,570	527,090
Less: Depreciation	(149,394)	(163,361)	(178,754)	(194,146)
Net fixed assets	328,869	323,078	309,816	332,944
Add: Capital WIP	31,343	35,852	76,332	114,852
Total fixed assets	360,212	358,930	386,148	447,795
Total Investment	85,847	95,096	95,096	95,096
Inventory	16,094	16,984	16,433	18,075
Debtors	38,095	38,282	37,041	40,743
Cash & bank	17,939	13,419	16,351	7,571
Loans & advances	13,843	13,720	13,276	14,602
Current liabilities	98,092	91,873	82,186	91,053
Net current assets	13,823	16,801	26,333	17,895
Other non-current assets	-	-	-	-
Total assets	**459,882**	**470,827**	**507,577**	**560,787**

Source: Company, Axis Capital

Cash flow (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	30,620	57,095	65,942	70,367
Depreciation & Amortisation	13,098	13,968	15,392	15,392
Chg in working capital	*29,737*	*(7,498)*	*(6,600)*	*(343)*
Cash flow from operations	**77,539**	**43,957**	**56,547**	**62,846**
Capital expenditure	*(28,013)*	*(12,686)*	*(42,610)*	*(77,040)*
Cash flow from investing	**(28,013)**	**(12,686)**	**(42,610)**	**(77,040)**
Equity raised/ (repaid)	-	*4,228*	-	-
Debt raised/ (repaid)	*(32,811)*	*(25,692)*	*15,000*	*30,000*
Dividend paid	*(8,384)*	*(18,030)*	*(24,409)*	*(26,047)*
Cash flow from financing	**(41,195)**	**(39,494)**	**(9,409)**	**3,953**
Net chg in cash	8,331	(8,223)	4,528	(10,241)

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	13.2	22.5	27.3	29.1
CEPS (Rs)	20.9	29.0	36.4	38.2
DPS (Rs)	4.1	9.1	12.3	13.1
Dividend payout ratio (%)	31.3	43.8	45.0	45.0
GROWTH				
Net sales (%)	(8.8)	(6.9)	0.3	10.0
EBITDA (%)	(8.9)	49.8	17.3	8.8
Adj net profit (%)	(25.2)	70.8	21.4	6.7
FDEPS (%)	(25.2)	70.8	21.4	6.7
PERFORMANCE				
RoE (%)	6.9	10.4	11.8	11.9
RoCE (%)	8.7	13.3	14.6	14.7
EFFICIENCY				
Asset turnover (x)	1.3	1.2	1.1	1.1
Sales/ total assets (x)	1.0	0.9	0.8	0.9
Working capital/ sales (x)	-	-	-	-
Receivable days	26.9	29.0	28.0	28.0
Inventory days	12.4	14.9	14.7	14.7
Payable days	22.0	23.8	21.7	21.9
FINANCIAL STABILITY				
Total debt/ equity (x)	0.2	0.1	0.1	0.2
Net debt/ equity (x)	0.2	0.1	0.1	0.2
Current ratio (x)	1.1	1.2	1.3	1.2
Interest cover (x)	3.7	10.5	10.6	8.1
VALUATION				
PE (x)	28.9	16.9	13.9	13.1
EV/ EBITDA (x)	16.2	10.5	9.1	8.8
EV/ Net sales (x)	1.3	1.4	1.4	1.4
PB (x)	1.8	1.7	1.6	1.5
Dividend yield (%)	1.1	2.4	3.2	3.4
Free cash flow yield (%)	7.7	4.9	2.2	(2.2)

Source: Company, Axis Capital

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, authors (Research team) and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associates do not have any material conflict of interest. I/we have not served as director, officer or employee in the subject company.

Research Team

Sr. No	Name	Designation	E-mail
1	Akhand Singh	Research Analyst	akhand.singh@axissecurities.in
2	Poonam Darade	Research Associate	poonam.darade@axissecurities.in

5. ASL or its associates has not received any compensation from the subject company in the past twelve months. ASL or its Research Analysts has not been engaged in market making activity for the subject company.

6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

i. Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;
ii. Managed or co-managed public offering of the securities from the subject company of this research report and / or;
iii. Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report

Term& Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advise necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Axis Securities Limited, Corporate office: Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808/022-61480808, Regd. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkarMarg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, Email: compliance.officer@axisdirect.in, Tel No: 022-42671582.