



**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	■	↔	■

<b>Reco/View</b>	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 149</b>	
Price Target: <b>Rs. 175</b>	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

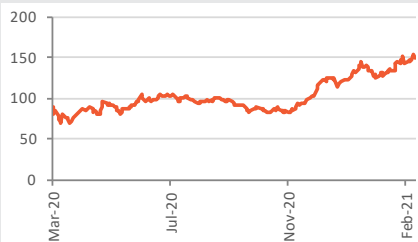
**Company details**

Market cap:	Rs. 67,201 cr
52-week high/low:	Rs. 158 / 66
NSE volume: (No of shares)	225.9 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	215.9 cr

**Shareholding (%)**

Promoters	52.1
FII	15.6
DII	19.9
Others	12.4

**Price chart**



**Price performance**

(%)	1m	3m	6m	12m
Absolute	13.4	22.5	57.8	65
Relative to Sensex	14.0	10.6	24.8	22

Sharekhan Research, Bloomberg

<b>Oil &amp; Gas</b>	<b>Sharekhan code: GAIL</b>	<b>Company Update</b>
----------------------	-----------------------------	-----------------------

**Summary**

- Recent sharp rally in oil price has improved the earnings outlook for GAIL's downstream segments – petchem and LPG-LHC. Higher oil/stable spot LNG price of \$6-7/mmbtu to improve competitiveness of GAIL's US LNG contracts and drive strong earning growth (expect a 29% PAT CAGR over FY21E-FY23E).
- Higher petchem plant utilisation (already at 106%) and commissioning of pipeline infrastructure projects (Urja Ganga and Barauni-Guwahati) to drive sustainable growth for gas transmission/marketing volume.
- Potential inclusion of gas under GST and likely value unlocking from monetization of gas pipeline assets would be key re-rating catalyst for GAIL in FY2022.
- GAIL is trading at an attractive valuation of 6.5x its FY2023E EV/EBITDA (27% discount to historical average EV/EBITDA multiple) and offers healthy dividend yield of ~5%. Hence, we maintain our Buy rating on GAIL with a revised PT of Rs. 175.

The recent sharp recovery in Brent crude oil price to ~\$68-70/bbl has considerably improved the earnings visibility for GAIL's downstream businesses (petrochemical and LPG-LHC segments, both combined accounted for 37% of overall EBITDA in Q3FY2021). International HDPE price has improved sharply and is hovering at ~\$1,150/tonne currently as compared to \$1,011/mt in Q3FY2021. GAIL's petrochemical plant is running at full utilisation (106% in Q3FY2021). Furthermore, Asian spot LNG price has remained at elevated level of \$18.5/\$12.7 per mmbtu in January/February 2021 and is still at a comfortable level of \$6-7/mmbtu, which bodes well for turnaround of GAIL's gas trading business and gives confidence with respect to normalisation of EBITDA to Rs. 2,200 crore-2,500 crore from gas trading over FY2022E-FY2023E. The company's gas transmission business is on firm footing, as commissioning of new pipelines, ramp-up of domestic gas production, and favourable regulatory environment (unified tariff and target to increase share of gas to 15% by 2030) would drive sustained volume-led earnings growth from the segment. Additionally, potential inclusion of natural gas under GST regime could substantially improve gas consumption in India and could act as a key trigger for volume growth across GAIL's gas transmission and marketing segments. We have increased our FY2022-FY2023 earnings estimates to factor in higher EBITDA from the petchem business and expect GAIL's EBITDA/PAT to post a strong 30%/29% CAGR over FY2021E-FY2023E. GAIL's valuation of 6.5x its FY2023E EV/EBITDA (27% discount to historical average one-year forward EV/EBITDA multiple of 9x) seems attractive, given expectation of strong earnings revival, potential value unlocking from monetisation of gas pipeline assets, and dividend yield of ~5%. Hence, we maintain our Buy rating on GAIL with a revised PT of Rs. 175 (reflects higher value for the petchem segment and increased value of listed investments).

**Our Call**

**Valuation – Maintain Buy on GAIL with a revised PT of Rs. 175:** GAIL's stock price has run up sharply by 64% in the past six months, led by improving earnings outlook and favourable regulations (unified gas pipeline tariff). Despite the recent run up, GAIL's valuation of 6.5x its FY2023E EV/EBITDA is attractive, and we expect the company to be the key beneficiary of the government's aim to increase the share of gas in India's energy mix, as the same provides sustainable volume growth opportunity for its gas pipeline and trading business. Additionally, potential value unlocking from monetisation of gas pipeline assets would act as a key re-rating catalyst for GAIL. Hence, we maintain our Buy rating on GAIL with a revised PT of Rs. 175 (higher valuation for the petchem business and increased value of listed investments).

**Key Risks**

Lower-than-expected gas transmission and marketing volumes amid COVID-19 demand slowdown. A sharp decline in LNG price and international oil prices could impact profitability of gas trading, petrochemical, and LPG-LHC segments.

**Valuation (Standalone)**

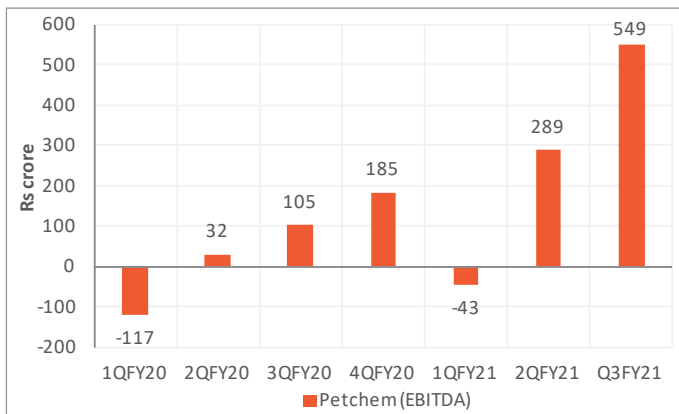
Particulars	Rs cr				
	FY19	FY20	FY21E	FY22E	FY23E
Revenue	75,126	71,871	60,698	81,065	85,677
OPM (%)	12.7	11.6	10.2	12.1	12.2
Adjusted PAT	6,352	6,519	4,237	6,715	7,026
% YoY growth	38.4	2.6	-35.0	58.5	4.6
Adjusted EPS (Rs)	14.1	14.5	9.4	14.9	15.6
P/E (x)	10.6	10.3	15.9	10.0	9.6
P/B (x)	1.5	1.5	1.4	1.3	1.2
EV/EBITDA (x)	7.0	8.6	11.4	7.0	6.5
RoNW (%)	15.0	14.8	9.4	13.9	13.4
RoCE (%)	18.7	14.1	9.9	14.9	14.8

Source: Company; Sharekhan estimates

### Sustained improvement in profitability of the petchem segment could drive consensus earnings upgrade

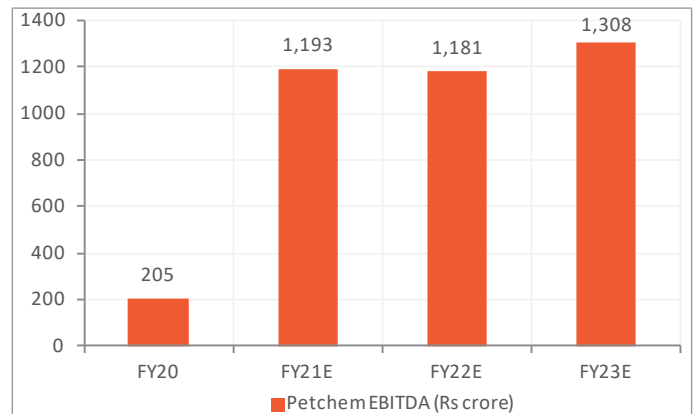
GAIL's petrochemical segment witnessed sharp recovery, with EBITDA at Rs. 795 crore in 9MFY2021 versus only Rs. 20 crore in 9MFY2020. The remarkable turnaround was led by strong improvement in HDPE price and higher capacity utilisation (which led to better absorption of fixed cost) despite EBITDA loss of Rs. 43 crore in Q1FY2021. We believe most of the triggers for turnaround in petchem profitability are sustainable as global economic recovery bodes well for better petrochemical prices. **International HDPE price at ~\$1,150/tonne currently (versus \$1,011/mt in Q3FY2021) and full capacity utilisation would result in sharp improvement in petchem EBITDA to Rs. 1,200 crore-1,300 crore in FY2021E-FY2023E versus only Rs. 205 crore in FY2020. We believe sustained high oil price in CY2021 would mean better HDPE realisation and could result into consensus earnings upgrade for GAIL.**

Petchem EBITDA saw sharp recovery over Q2FY21-Q3FY21



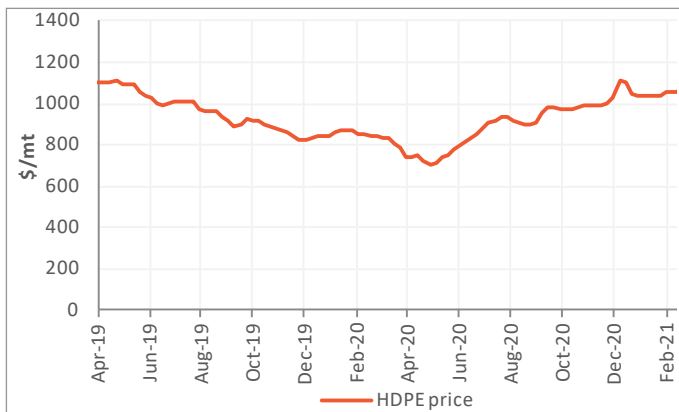
Source: GAIL

Petchem EBITDA turnaround to sustain



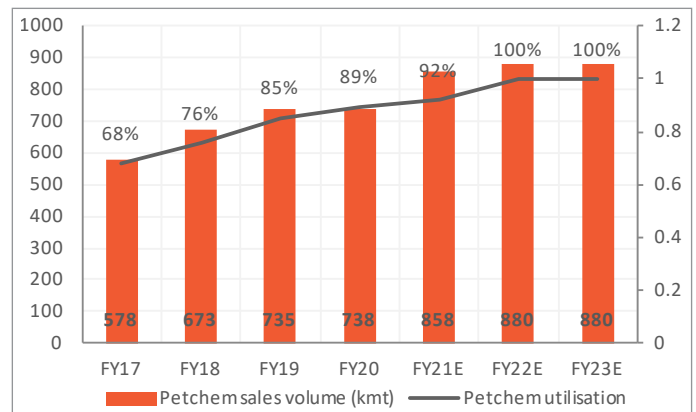
Source: GAIL; Sharekhan estimates

Improving HDPE prices bode well for petchem profitability



Source: Bloomberg

Petchem volume to improve over FY21-FY23



Source: GAIL; Sharekhan estimates

### Gas transmission and marketing volume could grow strongly led by infrastructure development and regulatory tailwinds

GAIL is expected to commission major pipelines such as Urja Ganga and Barauni-Guwahati over FY2022E-FY2023E and would get connectivity to fertiliser plants, refineries, and city gas distributors areas across the pipeline. Also, potential inclusion of natural gas under GST regime and government focus to increase share of gas to 15% by 2030 in India overall energy mix could substantially improve gas consumption in India and act as a key trigger for volume growth across GAIL's gas transmission and marketing segments.

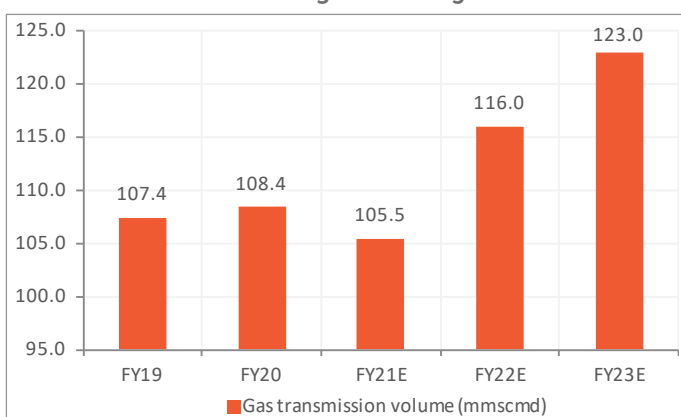
Management has guided for gas volume of 11 mmscmd from Urja Ganga pipeline, which would not only improve gas transmission volume but allay concerns with regards to marketing of US LNG. Further, the recent recovery in crude price would improve competitiveness of GAIL's US LNG contracts and would make it profitable above \$60/bbl of oil price.

**GAIL gas pipeline project over FY2022E-FY2023E completion schedule**

Pipeline project	Estimated date of commissioning
KOCHI-KOOTTANAD-BANGALORE-MANGALORE PIPELINE PHASE-II	Feb-22
BARAUNI-GUWAHATI PIPELINE	Dec-21
BARAUNI-GUWAHATI PIPELINE	Dec-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Jul-22
SRIKAKULAM ANGUL PIPELINE PROJECT	Jun-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Mar-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Dec-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Dec-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Nov-22
SRIKAKULAM ANGUL PIPELINE PROJECT	May-21
SRIKAKULAM ANGUL PIPELINE PROJECT	Apr-21

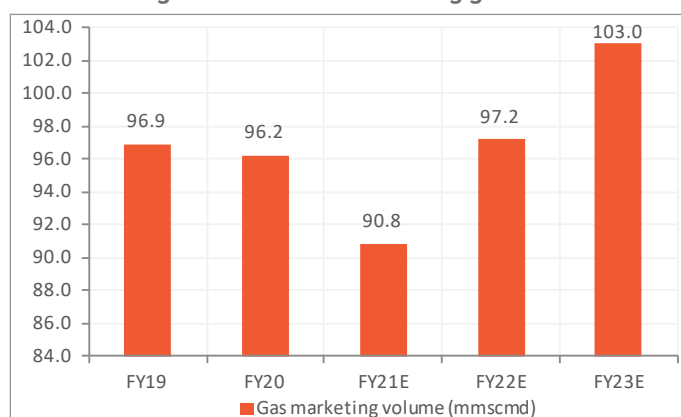
Source: Company; Industry Sources; Sharekhan Research

**Gas transmission volume to grow steadily**



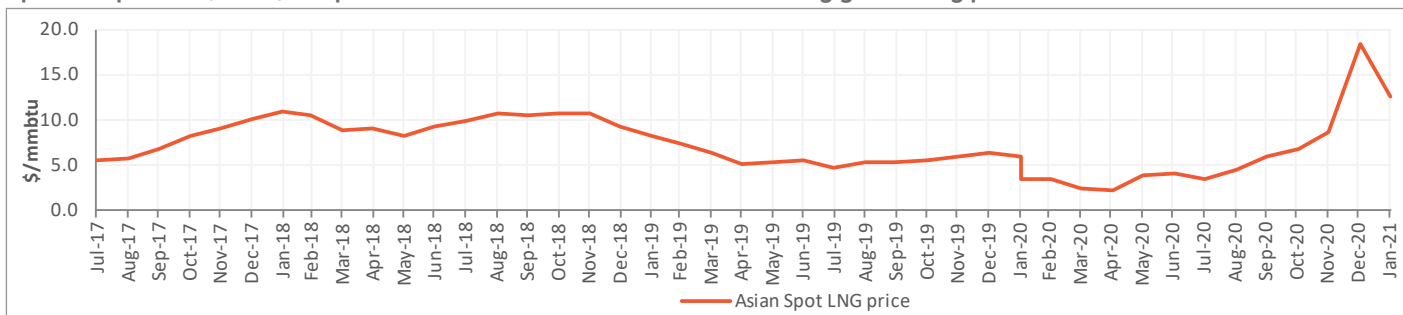
Source: Company, Sharekhan Research

**Gas marketing volumes are set for strong growth**



Source: Company, Sharekhan Research

**Spot LNG price of \$18.5/\$12.7 per mmbtu in Jan/Feb 2021 to result in strong gas trading performance**



Source: Bloomberg

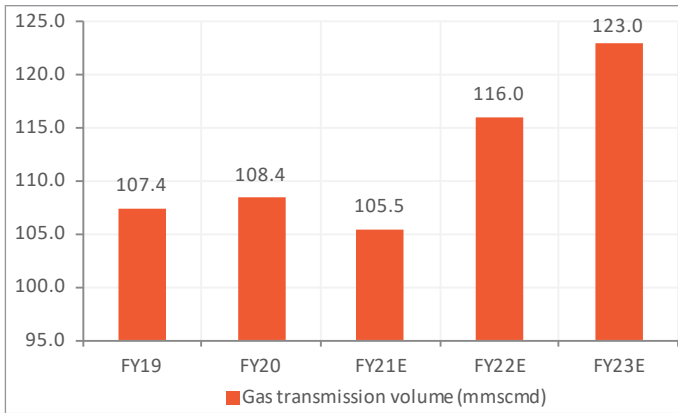
**Impact analysis of rising oil price on GAIL's US LNG contracts – Become profitable at <\$60/bbl**

Oil price (\$/bbl)	40	50	60	70	80
Henry Hub gas price (\$/mmbtu)	2.5	3.0	3.5	4.0	4.5
Indexation	115%	115%	115%	115%	115%
Price (\$/mmbtu)	2.9	3.5	4.0	4.6	5.2
Capacity charge (\$/mmbtu)	3	3	3	3	3
Swapping of gas	50%	50%	50%	50%	50%
Transportation cost (\$/mmbtu)	0.5	0.5	0.5	0.5	0.5
Landed price in Asia (\$/mmbtu)	6.4	7.0	7.5	8.1	8.7
Spot LNG price slope to oil price	13%	13%	13%	13%	13%
Spot LNG price	5.2	6.5	7.8	9.1	10.4
<b>Trading profit/(Loss) on US LNG contracts versus spot LNG price (\$/mmbtu)</b>	<b>-1.2</b>	<b>-0.4</b>	<b>0.3</b>	<b>1.0</b>	<b>1.7</b>

Source: Sharekhan Research

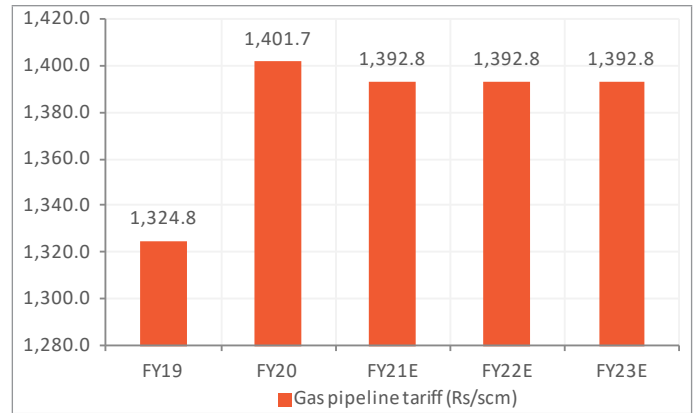
Financials in charts

Sustainable gas transmission volume growth



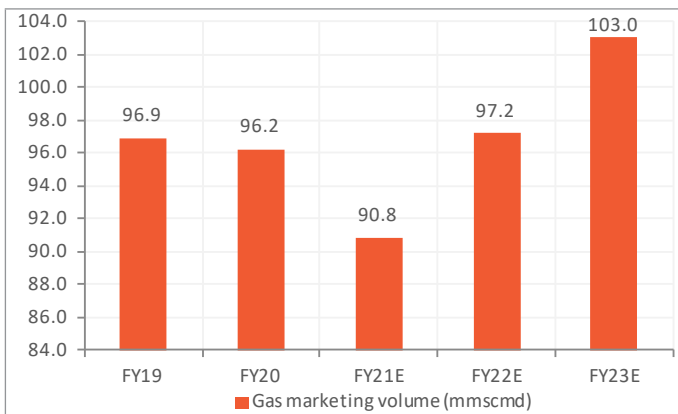
Source: Company, Sharekhan Research

Gas pipeline tariff to remain stable



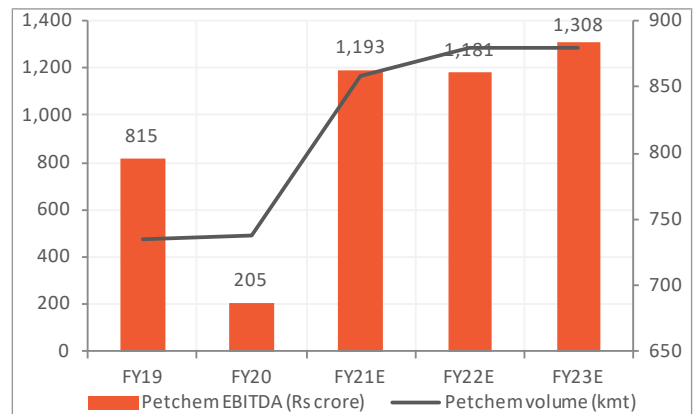
Source: Company, Sharekhan Research

Gas marketing volume to post 6% CAGR over FY21-FY23



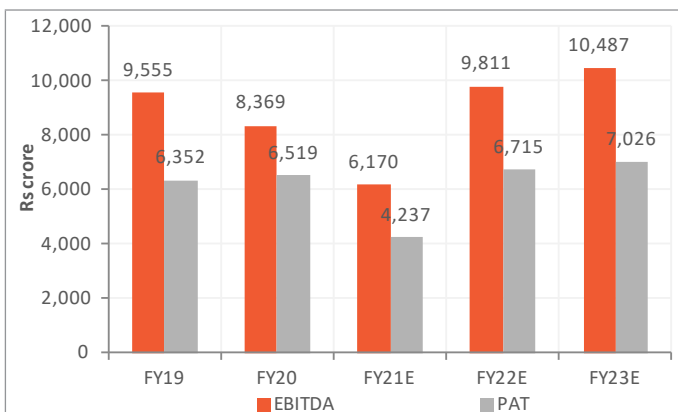
Source: Company, Sharekhan Research

Petchem utilisation and profitability to improve



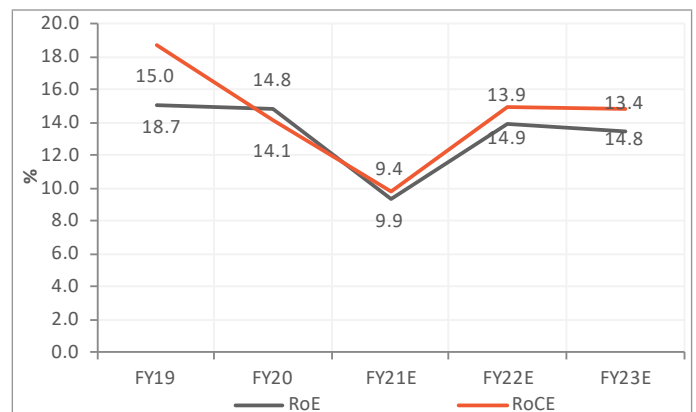
Source: Company, Sharekhan Research

EBITDA/PAT trend



Source: Company, Sharekhan Research

Return ratios to improve over FY22E-FY23E



Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Ramp-up of infrastructure and low gas prices to boost gas transmission volumes

We expect strong gas transmission volumes for gas utilities to be supported by robust gas demand outlook led by: 1) higher demand from the power, CGD, and fertiliser sectors; 2) regulatory push to switch to gas from polluting industrial/auto fuels; and 3) low domestic gas prices. Moreover, share of gas in India's overall energy mix is only at 6.3% as compared to the global average of 24.2%. The government's target to increase the share of gas to 15% by 2025 would drive robust gas consumption. Thus, we expect sustainable mid-single digit growth in India's gas demand for the next 4-5 years.

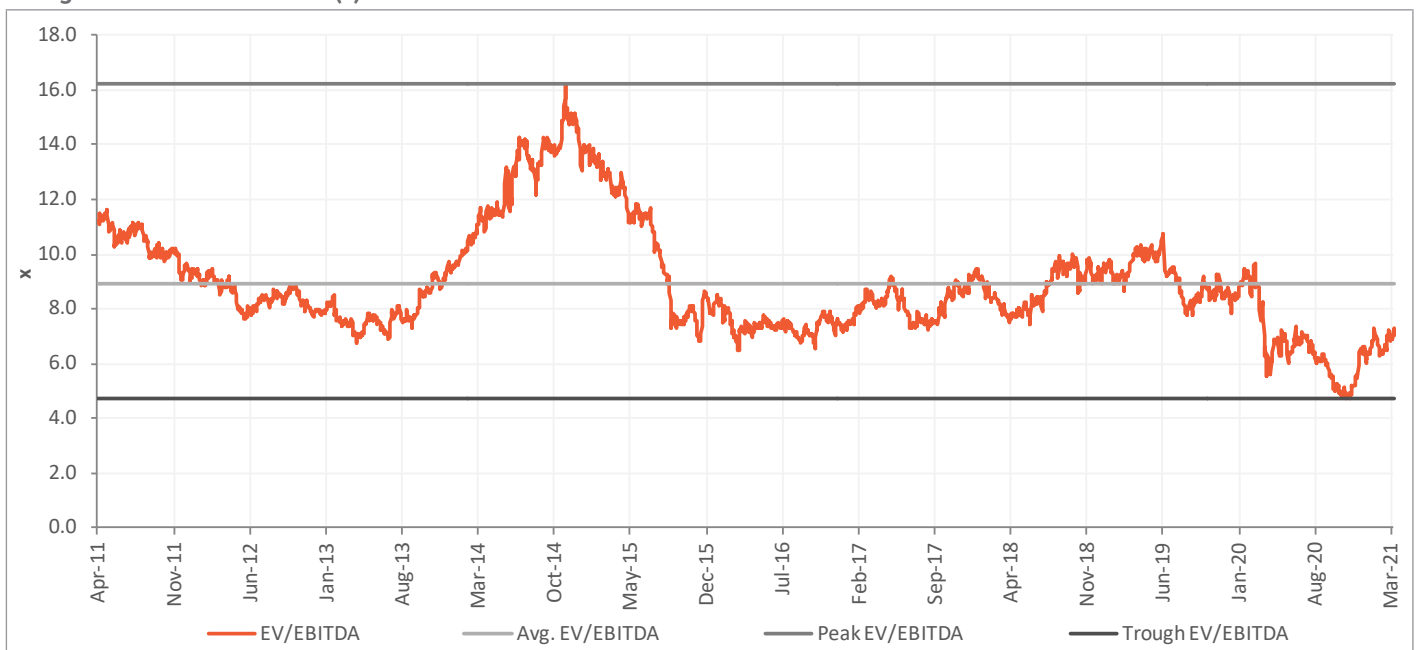
### ■ Company outlook - Volume revival to aid earnings recovery

GAIL's gas transmission volumes have recovered close to pre-COVID-19 levels and are currently above FY2020 level of 108 mmscmd. The sharp recovery in volumes, >100% utilisation of petchem plants, lower domestic gas price, and improvement in petchem prices would drive earnings revival for GAIL over the next few quarters. Low gas price and regulatory support would mean sustainable 5%-6% volume growth for the gas transmission and trading business over the medium to long term.

### ■ Valuation - Maintain Buy on GAIL with a revised PT of Rs. 175

GAIL's stock price has run up sharply by 64% in the past six months, led by improving earnings outlook and favourable regulations (unified gas pipeline tariff). Despite the recent run up, GAIL's valuation of 6.5x its FY2023E EV/EBITDA is attractive, and we expect the company to be the key beneficiary of the government's aim to increase the share of gas in India's energy mix, as the same provides sustainable volume growth opportunity for its gas pipeline and trading business. Additionally, potential value unlocking from monetisation of gas pipeline assets would act as a key re-rating catalyst for GAIL. Hence, we maintain our Buy rating on GAIL with a revised PT of Rs. 175 (higher valuation for the petchem business and increased value of listed investments).

#### One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

## About company

GAIL is a dominant domestic gas utility company primarily engaged in gas transmission and marketing businesses. The company owns ~10,900 km of gas pipelines and holds a ~78% market share in India's natural gas transmission business. GAIL also owns and operates gas-based petrochemical plants with a capacity of 880 ktpa and LPG-LHC production facilities. The company also holds a substantial interest in city gas distribution (CGD) business with stakes in CGD companies or through subsidiaries. GAIL also owns LNG import terminals.

## Investment theme

Strong gas demand supported by favourable regulatory environment and improving gas supplies (through upcoming LNG terminals and higher domestic gas production) bode well for improvement in GAIL's gas transmission volumes in the next 2-3 years. Moreover, stabilisation of petrochemical capacity would help in higher production and the benefit of better realisation (supported by stable-to-rising oil prices) bodes well for an earnings revival in the segment. Potential inclusion of natural gas under GST and likely monetisation of gas pipeline assets are key catalyst for GAIL in FY2022.

## Key Risks

- ◆ Lower-than-expected gas transmission and marketing volumes amid COVID-19 demand slowdown.
- ◆ A sharp decline in oil prices could impact petrochemical and LPG-LHC realisation and profitability of the segments.

## Additional Data

### Key management personnel

Manoj Jain	Chairman and MD
A.K. Tiwari	Director (Finance)
E.S. Ranganathan	Director (Marketing)

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential Asset Management	3.3
2	HDFC Asset Management Company Ltd	2.5
3	Vanguard Group Inc/The	1.3
4	Franklin Resources Inc	1.2
5	SBI Funds Management Pvt Ltd	1.1
6	BlackRock Inc	1.0
7	Norges Bank	0.8
8	Dimensional Fund Advisors LP	0.6
9	FMR LLC	0.5
10	UTI Asset Management Company Ltd	0.5

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

## 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

# Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

---

**Disclaimer:** This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document 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 document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

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 SHAREKHAN and affiliates 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. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: [compliance@sharekhan.com](mailto:compliance@sharekhan.com);

For any queries or grievances kindly email [igc@sharekhan.com](mailto:igc@sharekhan.com) or contact: [myaccount@sharekhan.com](mailto:myaccount@sharekhan.com)

---

**Registered Office:** Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. 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; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on [www.sharekhan.com](http://www.sharekhan.com); Investment in securities market are subject to market risks, read all the related documents carefully before investing.