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Stock Update

GAIL (India) Limited

Robust Q4; High crude linked commodity price bodes well for earnings

Oil & Gas	Sharekhan code: GAIL	Result Update

Summary

- Q4FY2021 PAT of Rs. 1,908 crore (up 28.3% q-o-q) was 15.6% above our estimate, led by strong performance across commodity-linked businesses of petchem/LPG-LHC/gas marketing supported by higher oil price.
- Q1FY2022 gas transmission volume to get impacted by lockdown in April 2021-May 2021 and petchem utilisation due to maintenance plant shut down; however, high HDPE, LPG, and spot LNG prices would keep profitability strong.
- Earnings growth outlook (expect a 29% PAT CAGR over FY2021-FY2023E) has improved considerably, given high profitability for petchem and LPG-LHC segments post the sharp rally in oil price to <$70/bbl. Transmission volume to grow steadily at 6-8% volume p.a.
- Valuation of 7x its FY2023E EV/EBITDA seems attractive, given expectation of strong earnings revival and potential value unlocking from monetisation of gas pipeline assets. We maintain our Buy rating on GAIL with a revised PT of Rs. 196.

GAIL (India) Limited's Q4FY2021 operating profit at Rs. 2,565 crore (up 33.6% q-o-q) was 12% above our estimate of Rs. 2,290 crore, led by sharp beat in petrochemical EBITDA at Rs. 724 crore (up 3.9x y-o-y; up 31.9% q-o-q), LPG-LHC EBITDA of Rs. 496 crore (up 63.2% q-o-q), and turnaround of gas marketing business (EBITDA of Rs. 299 crore versus EBITDA loss of Rs. 45 crore in Q3FY2021). All commodities-driven segments witnessed margin improvement with Rs. 10,000/tonne q-o-q rise in petchem realisation, 27% q-o-q rise in LPG-LHC segment realisation, and better gas marketing margin, given higher spot LNG price in January 2021-February 2021. However, LPG-LHC volumes declined by 19.4% q-o-q to 257 kt due to lower quality of domestic gas, while gas marketing volume was down by 4.4% q-o-q to 91mmscmd. Petchem plant continued to operate at high utilisation rate of 102% and posted sales volume of 234 kt (up 1.3% q-o-q). The gas transmission segment's performance was steady with EBITDA of Rs. 1,204 crore (up 3.4% y-o-y; down 3.4% q-o-q) with stable gas transmission volume of 110mmscmd (flat q-o-q but 2% below our estimate). PAT at Rs. 1,906 crore (up 28.3% q-o-q) was also 15.6% above our estimate of Rs. 1,650 crore, led by strong performance of crude linked commodity businesses and higher other income (up 21% q-o-q). Management has indicated that gas transmission volume got impacted by 10-15% in April 2021-May 2021 due to lockdown but have reverted to 110mmscmd in June 2021, while petchem plan utilisation will be lower in Q1FY2022 due to maintenance shutdown. Notwithstanding lower volume, we expect GAIL's Q1FY2022 performance to remain strong, supported by sustained improvement in profitability (petchem and LPG-LHC) as rising oil price bodes well for realisations. Moreover, management's guidance of 6-8% annual growth in gas transmission volume would result in steady earnings growth for the gas transmission segment. GAIL's valuation of 7x its FY2023E EV/EBITDA (21% discount to historical average one-year forward EV/EBITDA multiple of 8.8x) seems attractive, given expectation of strong earnings revival and potential value unlocking from monetisation of gas pipeline assets (plans to list two gas pipelines through InvIT). Hence, we maintain our Buy rating on GAIL with a revised PT of Rs. 196.

Key positives

- Sharp improvement in profitability of the petchem/LPG-LHC segment with EBITDA growth of 32%/63% q-o-q.
- Turnaround of the gas trading segment with EBITDA of Rs. 299 crore versus EBITDA loss of Rs. 45 crore in Q3FY2021.

Key negatives

- Marginally lower-than-expected gas transmission volume of 110mmscmd (flat q-o-q and 2% below our estimate).

Our Call

Valuation – Maintain Buy on GAIL with a revised PT of Rs. 196: We have increased our FY2022-FY2023 earnings estimates to factor improved profitability for the petrochemical and LPG-LHC business. GAIL's stock price has run up sharply by 30% in the past six months, led by improving earnings outlook for its crude linked commodity businesses. Despite the recent run up, GAIL's valuation of 7x 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. 196 (increase in PT reflects higher valuation for the petchem and LPG-LHC business).

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.

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 163**	
Price Target: **Rs. 196**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

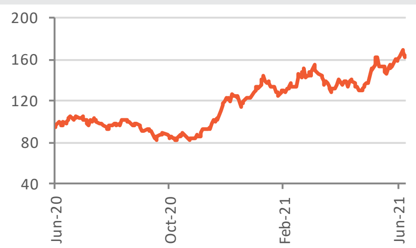
Company details

Market cap:	Rs. 72,578 cr
52-week high/low:	Rs. 170 / 81
NSE volume: (No of shares)	230.9 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	217.3 cr

Shareholding (%)

Promoters	51.8
FII	15.6
DII	19.3
Others	13.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.0	11.3	29.8	71
Relative to Sensex	-5.4	8.3	16.4	15

Sharekhan Research, Bloomberg

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	71,871	56,730	81,540	86,542
OPM (%)	11.6	11.4	13.0	13.4
Adjusted PAT	6,519	4,890	7,544	8,121
% YoY growth	*2.6*	*-25.0*	*54.3*	*7.7*
Adjusted EPS (Rs)	14.7	11.0	17.0	18.3
P/E (x)	11.1	14.8	9.6	8.9
P/B (x)	1.7	1.6	1.4	1.3
EV/EBITDA (x)	9.2	11.9	7.2	7.0
RoNW (%)	14.8	10.8	15.5	15.2
RoCE (%)	14.1	10.8	15.7	15.3

Source: Company; Sharekhan estimates

Sharp beat in PAT led by strong performance of crude linked commodity businesses and higher other income; High petchem/LPG-LHC profitability and turnaround of gas marketing business is a positive

GAIL's Q4FY2021 operating profit at Rs. 2,565 crore (up 33.6% q-o-q) was 12% below our estimate of Rs. 2,290 crore, led by sharp beat in petrochemical EBITDA at Rs. 724 crore (up 3.9x y-o-y; up 31.9% q-o-q), LPG-LHC EBITDA of Rs. 496 crore (up 63.2% q-o-q), and turnaround of gas marketing business (EBITDA of Rs. 299 crore versus loss of Rs. 45 crore in Q3FY2021). All commodity-driven segments witnessed margin improvement with Rs. 10,000/tonne q-o-q rise in petchem realisation, 27% q-o-q rise in LPG-LHC segment realisation, and better gas marketing margin given higher spot LNG price in January 2021-February 2021. However, LPG-LHC volumes declined by 19.4% q-o-q to 257 kt due to lower quality of domestic gas, while gas marketing volume was down by 4.4% q-o-q to 91mmscmd. Petchem plant continued to operate at high utilisation rate of 102% and posted sales volume of 234 kt (up 1.3% q-o-q). The gas transmission segment's performance was steady with EBITDA of Rs. 1,204 crore (up 3.4% y-o-y; down 3.4% q-o-q) with stable gas transmission volume of 110mmscmd. PAT at Rs. 1,906 crore (up 28.3% q-o-q) was also 15.6% above our estimate of Rs. 1,650 crore, led by strong performance of commodity-led business and higher other income (up 21% q-o-q).

Q4FY2021 results conference call highlights

- **COVID-19 impact on gas transmission volumes –** Gas transmission volumes got impacted by 10-15% in April 2021-May 2021, as gas demand was lower due to the lockdown, but volumes have recovered back to 110mmscmd in June 2021. Petchem utilisation is likely to be slightly lower in Q1FY2022 due to planned maintenance shutdown at PATA petrochemical plant.
- **Gas marketing business outlook –** In the gas trading business, 80% of the volume from US LNG contracts has been tied-up for FY2022 and 50% of the volume is tied up for FY2023. With Asian spot LNG prices higher than US Henry Hub natural gas prices, profitability for the gas marketing business is likely to improve going forward.
- **Gas transmission volume growth outlook –** Management expects 6-8% annual volume growth for the next three years and has guided for volume of 114mmscmd -115mmscmd for FY2022. Management expects gas transmission volume growth outlook would further improve post the commencement of National Gas Grid. Growth opportunity is likely to further increase. In the next 4-5 years, management expects the pipeline utilisation rate to increase to 70-75% versus 51% currently, as gas demand would improve from new fertilizer plants (11-12mmscmd), expansion of refinery/petchem plants, and higher CGD demand.
- **Potential offtake from fertilizer plant –** Fertilizer plants are operating at full utilisation despite high LNG prices. Gorakhpur commissioning is ongoing and management expects peak capacity by August 2021-September 2021. For Barauni/Sindri, pre-commissioning is going on and there is some delay; and offtake will take place by July.
- **Capex guidance –** Management has guided for capex of Rs. 7,000 crore/Rs. 1,2000 crore for FY2022/ FY2023 as compared to capex spending of Rs. 7,000 crore (largely spent on pipelines) in FY2021. The company also has a plan of Rs. 10,000 crore capex for PATA petrochemical plant (setting up polypropylene plant).
- **Pipeline monetisation update –** Management has identified two gas pipelines for monetisation through InvIT route, details of which have not yet been disclosed. The company has sought approval of the oil ministry and regulator (PNGRB) for gas pipeline InvIT.
- **Urja Ganga pipeline –** Work on Urja Ganga pipeline is progressing well and the company expects to complete it by December 2021 except for Durgapur to Haldia pipeline section. Total capex for Urja Ganga pipeline is estimated at Rs. 15,000 crore - 16,000 crore, of which GAIL has spent Rs. 11,300 crore and received government capital grants of Rs. 4,487 crore.
- **National Gas Grid update –** The national gas grid would have eight gas pipelines with 7,500 km and would be built at a capex of Rs. 36,400 crore. Overall, GAIL is implementing 71 projects with total capex plan of Rs. 47,500 crore.
- **New business avenues –** The company is focused on investing in new areas such as compressed bio-gas plants, ethanol plant, and renewable energy (target of 1GW of solar/wind power portfolio).
- **US LNG cargos –** GAIL has purchased total 119 LNG cargos, of which 83 were sourced from the US in FY2021. In FY2021, 35 cargos were sold in the international market.

Results Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Reported net Sales	15,546	17,753	-12.4	15,454	0.6
Adjusted net sales	15,546	17,753	-12.4	15,454	0.6
Total Expenditure	12,981	15,278	-15.0	13,535	-4.1
Reported operating profit	**2,565**	**2,475**	**3.6**	**1,920**	**33.6**
Adjusted operating profit	**2,565**	**2,475**	**3.6**	**1,920**	**33.6**
Other Income	568	513	10.8	471	20.7
Interest	46	33	39.2	33	38.4
Depreciation	476	502	-5.1	490	-2.8
Exceptional income/(expense)	0	-102	NA	0	NA
Reported PBT	2,612	2,556	2.2	1,868	39.8
Adjusted PBT	2,612	2,454	6.4	1,868	39.8
Tax	704	-463	NA	380	85.1
RPAT	1,908	3,018	-36.8	1,487	28.3
Adjusted PAT	1,908	2,246	-15.1	1,487	28.3
Equity Cap (cr)	451	451		451	
Reported EPS (Rs.)	4.2	6.7	-36.8	3.3	28.3
Adjusted EPS (Rs.)	4.2	5.0	-15.1	3.3	28.3
Margins (%)			**BPS**		**BPS**
Adjusted OPM	16.5	13.9	255	12.4	408
Effective tax rate	27.0	-18.1	4505	20.4	659
Adjusted NPM	12.3	17.0	-473	9.6	265

Source: Company; Sharekhan Research

Segmental EBITDA Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Natural gas transmission	1,204	1,164	3.4	1,247	-3.4
LPG transmission	104	110	-5.5	109	-4.6
Natural gas trading	299	631	-52.6	-45	NA
Petrochemicals	724	185	291.4	549	31.9
LPG and Liquid hydrocarbons	496	554	-10.5	304	63.2
Others	307	446	-31.2	227	35.2
Total EBITDA	**3,134**	**3,090**	**1.4**	**2,391**	**31.1**

Source: Company; Sharekhan Research

Segment-wise volume performance

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Natural gas transmission (mmscmd)	110	109	0.7	110	-0.5
LPG transmission (kmt)	1,054	1,040	1.3	1,088	-3.1
Natural gas trading (mmscmd)	91	98	-6.5	96	-4.4
Petrochemicals (kmt)	234	174	34.5	231	1.3
LPG and Liquid hydrocarbons (kmt)	257	302	-14.9	319	-19.4

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Ramp-up of infrastructure and regulatory support 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 – High commodity price bodes well for earnings growth

Earnings outlook for GAIL's petchem and LPG-LHC segment (both combined accounted for 36% of overall EBITDA) has improved considerably, given high HDPE/LPG price post the sharp rally in oil price to <$70/bbl. Moreover, high spot LNG price of $10/mmbtu bodes well for turnaround of loss-making gas trading business and provides confidence with respect to normalisation of EBITDA to Rs. 2,200 crore - 2,500 crore. Moreover, low gas price and regulatory support would mean sustainable 6-8% volume growth for the gas transmission and trading business over the medium to long term. Hence, we expect GAIL's PAT to post a 29% CAGR over FY2021-FY2023E.

■ Valuation – Maintain Buy on GAIL with a revised PT of Rs. 196

We have increased our FY2022-FY2023 earnings estimates to factor improved profitability for the petrochemical and LPG-LHC business. GAIL's stock price has run up sharply by 30% in the past six months, led by improving earnings outlook for its crude linked commodity businesses. Despite the recent run up, GAIL's valuation of 7x 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. 196 (increase in PT reflects higher valuation for the petchem and LPG-LHC business).

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 catalysts 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 Co. Ltd.	3.4
2	ICICI Prudential Equity	2.8
3	HDFC Asset Management Co. Ltd.	2.4
4	Vanguard Group Inc.	1.4
5	BlackRock Inc.	1.1
6	Franklin Resources Inc.	1.1
7	Norges Bank	0.7
8	SBI Funds Management Pvt. Ltd.	0.6
9	Dimensional Fund Advisors LP	0.6
10	FMR LLC	0.5

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

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