Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

GAIL (India) Ltd

Record gas marketing biz profitability lifts Q3

Oil & Gas		Sharekhan code: GAIL		
Reco/View: Buy	↔	CMP: **Rs. 147**	Price Target: **Rs. 196**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 28.62

Updated Jan 08, 2022

Medium Risk

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

Source: Morningstar

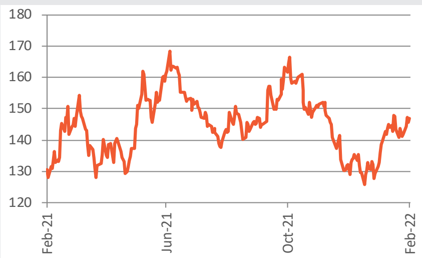
Company details

Market cap:	Rs. 65,229 cr
52-week high/low:	Rs. 171 / 125
NSE volume: (No of shares)	122.3 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	217.4 cr

Shareholding (%)

Promoters	51.8
FII	19.7
DII	15.3
Others	13.3

Price chart



Price performance

()	1m	3m	6m	12m
Absolute	10.7	-3.0	3.1	12
Relative to Sensex	12.4	-0.9	-5.0	-4

Sharekhan Research, Bloomberg

Summary

- Q3FY22 PAT of Rs. 3,288 crore, up 121%/15% y-o-y/q-o-q was significantly above our and street estimate led by exceedingly high profitability in the gas marketing biz (EBITDA up 60% q-o-q) and LPG-LHC (EBITDA up 24% q-o-q) and higher other income.
- Robust performance of the gas marketing division reflects higher implied gas trading spreads given the benefit of high spot LNG prices, while higher LHC realisations (up 26% q-o-q) and better volume (up 5% q-o-q) lifted performance of LPG-LHC segment. EBITDA of gas transmission/petchem segments remained steady on q-o-q.
- The management indicated that gas trading margins may moderate little bit in Q4 and gas transmission volume to see some q-o-q decline due to shutdown of fertiliser plants. GAIL guided for a steady increase in gas transmission/marketing volumes and sustained petchem profitability; hike in domestic gas prices would only minimally impact LPG-LHC margins given higher LPG prices.
- Valuation of 5.7x FY23E EV/EBITDA is attractive considering a strong earnings growth outlook and improving return profile (expect RoE of 16% over FY22E-24E). We maintain a Buy on GAIL with an unchanged PT of Rs. 196.

GAIL (India) Limited reported stellar Q3FY22 results with a large beat of 16%/24% in operating profit/PAT at Rs. 4,228 crore/Rs. 3,288 crore, up 120%/121% y-o-y primarily led by stronger-than-expected earnings growth in gas marketing/LPG-LHC segments, higher other income and marginally lower tax rate. Gas marketing EBITDA grew strongly by 60% q-o-q to Rs. 1,750 crore (versus an EBITDA loss of Rs. 45 crore in Q3FY21) led by a sharp improvement in gas trading spreads due to elevated spot LNG price while EBITDA from LPG-LHC was at Rs. 875 crore (up 188% y-o-y; up 24.5% q-o-q) supported by 26% q-o-q increase in LPG-LHC realisation and better volume (up 5% q-o-q with utilisation of 77% versus 74% in Q2FY22). Gas transmission volume increased by 3.6% y-o-y with steady EBITDA at Rs. 1,256 crore (flat y-o-y) while petchem performance was also good as it largely maintained EBITDA at Rs. 490 crore (up 1.7% q-o-q) reflecting strong petchem realisations despite elevated spot LNG prices.

Key positives

- Continued strength in gas marketing EBITDA (up 60% q-o-q) led by higher gas trading spreads.
- LPG-LHC segment's profitability improved led by 26% q-o-q rise in realisations and high utilisation of 77% versus 74% in Q2FY22.

Key negatives

- Petchem volumes declined by 6%/2% y-o-y/q-o-q to 217 kmt.

Management Commentary

- Gas transmission volume growth guidance of 5-6% annually in the next 2-3 years. However, current volumes are at 105 mmscmd due to shutdown of fertiliser plants and thus Q4 may witness some decline in volumes.
- The management expects gas marketing margins to be a little lower in Q4FY22 as compared to Q3FY22 and volume is expected to increase by 5-6 mmscmd in FY23.
- Confident of operating petchem plant at full utilisation and expects to clock strong petchem margins. Management does not expect any significant impact on LPG-LHC margins as high international LPG prices would offset a rise in domestic gas price.
- Identified two pipelines for monetisation and have appointed a transaction advisor and evaluating various options for asset monetisation.
- Capex guidance of Rs. 7,500 crore each for FY22 and FY23 and has spent Rs. 5000 crore in 9MFY22.

Revision in estimates – We have increased our FY22 earnings estimate to factor in higher profitability in gas trading and LPG-LHC segments partially offset by lower gas transmission volume. We have fine-tuned our FY23-24 earnings estimates.

Our Call

Valuation – Maintain Buy on GAIL with an unchanged PT of Rs. 196: GAIL's valuation of 5.7x its FY2023E EV/EBITDA (at a 33% discount to historical average one-year forward EV/EBITDA multiple of 8.6x) seems attractive, given expectations of a strong earnings outlook (expect 24% PAT CAGR over FY21-24E), improving RoE profile and potential value unlocking from monetisation of gas pipeline assets. Hence, we maintain a Buy on GAIL with an unchanged PT of Rs. 196.

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) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	56,730	85,015	89,217	94,595
OPM (%)	11.4	15.4	14.0	14.2
Adjusted PAT	4,890	9,412	8,795	9,310
% YoY growth	-25.0	92.5	-6.6	5.9
Adjusted EPS (Rs.)	11.0	21.2	19.8	21.0
P/E (x)	13.3	6.9	7.4	7.0
P/B (x)	1.4	1.3	1.1	1.0
EV/EBITDA (x)	10.8	5.2	5.7	5.6
RoNW (%)	10.8	19.1	16.1	15.6
RoCE (%)	10.8	19.3	16.3	15.7

Source: Company; Sharekhan estimates

Large earnings beat led by strong performance by gas marketing/LPG-LHC segments

Stellar Q3FY22 results with a large beat of 16%/24% in operating profit/PAT at Rs. 4,228 crore/Rs. 3,288 crore, up 120%/121% y-o-y primarily led by stronger-than-expected earnings growth in gas marketing/LPG-LHC segments, higher other income and marginally lower tax rate. Gas marketing EBITDA grew strongly by 60% q-o-q to Rs. 1,750 crore (versus an EBITDA loss of Rs. 45 crore in Q3FY21) led by a sharp improvement in gas trading spreads due to elevated spot LNG price while EBITDA from LPG-LHC was at Rs. 875 crore (up 188% y-o-y; up 24.5% q-o-q) supported by 26% q-o-q increase in LPG-LHC realisation and better volume (up 5% q-o-q with utilisation of 77% versus 74% in Q2FY22). Gas transmission volume increased by 3.6% y-o-y with steady EBITDA at Rs. 1,256 crore (flat y-o-y) while petchem performance was also good as it largely maintained EBITDA at Rs. 490 crore (up 1.7% q-o-q) reflecting strong petchem realisations despite elevated spot LNG prices.

Q3FY22 key conference call highlights

- **Gas transmission volume guidance –** Volume growth guidance of 5-6% annually for next 2-3 years led by higher supplies to CGD and upcoming fertiliser plants. However, Q4FY22 would see somewhat of a volume decline as current volume is at 105 mmscmd (versus 114 mmscmd in Q3) due to shutdown of fertiliser plants till February 20, 2022.
- **Gas trading margin outlook –** The management expects marketing margin to be little lower compared to Q3FY22 and volume is expected to increase by 5-6 mmscmd in FY23. ~90% of RLNG portfolio is contracted under long term and less than 5% of total volume is uncontracted.
- **Petchem/LPG-LHC outlook –** Confident to operate petchem plant at full utilisation and expects to strong petchem margins. Management does not expect any significant impact on LPG-LHC margins as international LPG prices to offset rise in domestic gas price.
- **Gas pipeline asset monetisation update –** GAIL has identified monetisation of two gas pipelines (2,229 km) - Dabhol-Bengaluru and Dahej-Uran-Panvel-Dabhol for monetisation and have appointed transaction advisor. GAIL is evaluating various modes of asset monetisation including InvITs. Nothing concrete have been finalized on asset monetisation as of now.
- **Update on fertiliser plants for gas volume offtake –** 1) Gorakhpur: Under pre-commissioning and taking 0.1-0.2 mmscmd. Commercial production expected by Apr-May'22, which would increase offtake to 2.2mmscmd. 2) Barauni & Sindri: Under pre-commissioning and taking 0.1-0.2 mmscmd. Commercial production expected by Oct-December 2022, which would increase offtake to 2.2 mmscmd each. Have a contract to supply 1.8 7mmscmd to each. 3) Ramagundam: Commercial production started in March 2021, Currently, the unit is taking 1.7 mmscmd – full offtake expected in Mar-Apr'22 to 2.2mmscmd. 4) Matix: Started in August 2021 – currently drawing full volumes of 1.5 mmscmd.
- **Capex guidance/pipeline projects –** Capex of Rs. 7,500 crore each for FY22 and FY23 and the company has spent Rs. 5000 crore in 9MFY22. The company is implementing 7,500 km of gas pipeline projects with total investment estimated at Rs. 37,000 crore. Urja-Ganga pipeline actual capex of Rs. 12,815 crore (out of total capex outlay of Rs. 15,530 crore) and have received government grant of Rs. 4,549 crore.

Results (standalone) Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Revenue	**25,770**	**15,454**	**66.7**	**21,511**	**19.8**
Total Expenditure	21,542	13,535	59.2	18,036	19.4
Operating profit	**4,228**	**1,920**	**120.3**	**3,475**	**21.7**
Other Income	652	471	38.4	774	-15.8
Interest	39	33	18.9	42	-7.1
Depreciation	532	490	8.7	524	1.5
PBT	4,308	1,868	130.7	3,682	17.0
Tax	1,020	380	168.3	819	24.5
Reported PAT	**3,288**	**1,487**	**121.1**	**2,863**	**14.8**
Equity Cap (cr)	444	444		444	
Reported EPS (Rs.)	7.4	3.3	121.1	6.4	14.8
Margins (%)			**BPS**		**BPS**
OPM	16.4	12.4	399	16.2	25
Effective tax rate	23.7	20.4	332	22.3	143
NPM	12.8	9.6	314	13.3	-55

Source: Company; Sharekhan Research

Segmental EBITDA Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Natural gas transmission	1,256	1,247	0.7	1,314	-4.4
LPG transmission	96	109	-11.9	98	-2.0
Natural gas trading	1,795	-45	NA	1,124	59.7
Petrochemicals	490	549	-10.7	482	1.7
LPG and Liquid hydrocarbons	875	304	187.8	703	24.5
Others	367	227	61.7	528	-30.5
Total EBITDA	**4,879**	**2,391**	**104.1**	**4,249**	**14.8**

Source: Company; Sharekhan Research

Segment-wise volume performance

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Natural gas transmission (mmscmd)	114	110	3.6	114	0.0
LPG transmission (kmt)	1,057	1,088	-2.8	1,054	0.3
Natural gas trading (mmscmd)	97	96	1.0	98	-1.2
Petrochemicals (kmt)	217	231	-6.1	221	-1.8
LPG and Liquid hydrocarbons (kmt)	275	319	-13.8	262	5.0

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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 for a shift to gas from polluting industrial/auto fuels; and 3) low domestic gas prices. Moreover, the 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 2030 would drive robust gas consumption. Thus, we expect sustainable mid-single digit growth in India's gas demand for the next 4-5 years.

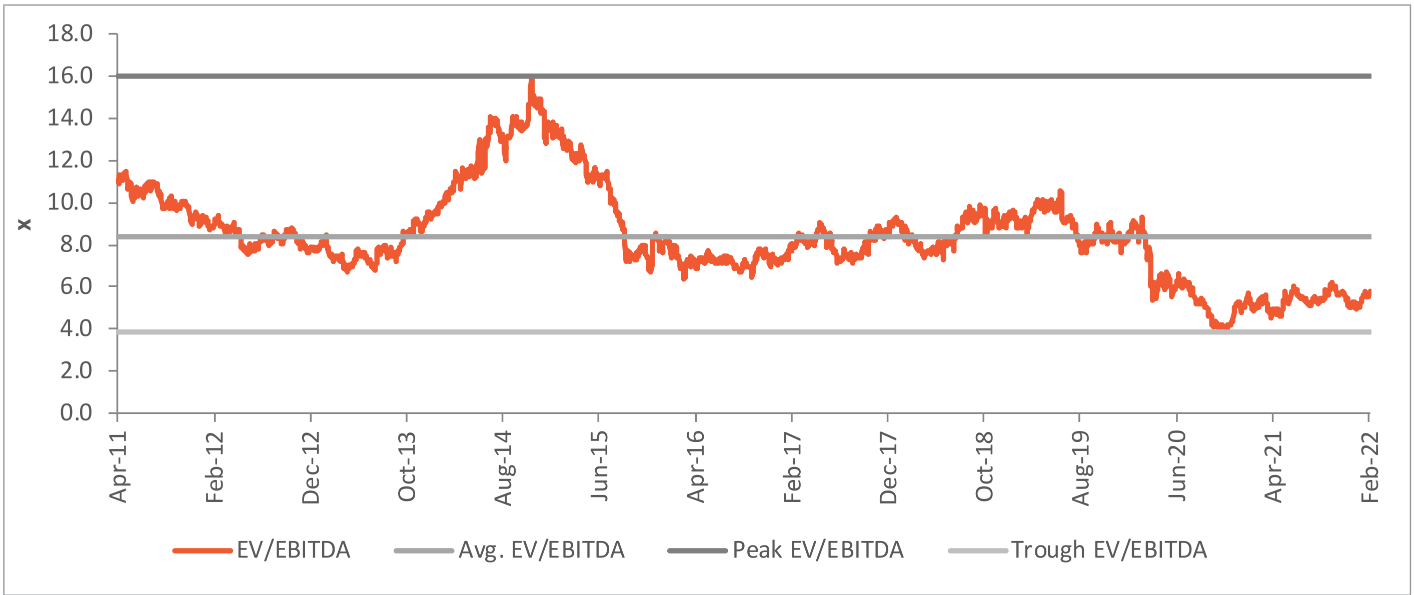
■ Company outlook – High commodity price and volume growth bodes well for earnings growth

Earnings outlook for GAIL's petchem and LPG-LHC segments has improved considerably, given a sharp rally in crude oil prices to ~$90/bbl. Moreover, high spot LNG price of >$30/mmBtu bodes well for sustained improvement in profitability for the gas trading business and provides confidence on higher-than historical EBITDA for the segment. Moreover, regulatory support would mean a sustainable 5-6% volume growth for gas transmission and trading business over the medium to long term. Hence, we expect GAIL's PAT to post a 24% CAGR over FY2021-FY2024E.

■ Valuation – Maintain Buy on GAIL with an unchanged PT of Rs. 196

GAIL's valuation of 5.7x its FY2023E EV/EBITDA (at a 33% discount to historical average one-year forward EV/EBITDA multiple of 8.6x) seems attractive, given expectations of a strong earnings outlook (expect 24% PAT CAGR over FY21-24E), improving RoE profile and potential value unlocking from monetisation of gas pipeline assets. Hence, we maintain a Buy on GAIL with an unchanged PT of Rs. 196.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

About the 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.

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)
M.V. Iyer	Director (Marketing)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	6.2
2	Oil & Natural Gas Corp Ltd	4.9
3	Indian Oil Corp Ltd	2.5
4	HDFC Asset Management Co. Ltd	1.9
5	Vanguard Group Inc./The	1.8
6	SBI Funds Management Ltd	1.5
7	ICICI Prudential Asset Management Co. Ltd/The	1.3
8	Government Pensi	1.2
9	BlackRock Inc.	1.0
10	Franklin Resources Inc.	0.8

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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