Sharekhan by BNP PARIBAS

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GAIL (India) Ltd

Dismal Q3 performance

Oil & Gas	Sharekhan code: GAIL	
Reco/View: Hold ↔	CMP: Rs. 95	Price Target: Rs. 100 ↑

↑ 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	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 28.31

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

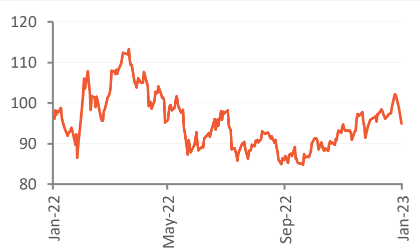
Company details

Market cap:	Rs. 62,431 cr
52-week high/low:	Rs. 116/83
NSE volume: (No of shares)	122 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	316.2 cr

Shareholding (%)

Promoters	51.9
FII	18.0
DII	16.0
Others	14.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.2	4.0	-2.7	-1.2
Relative to Sensex	1.0	6.0	-6.1	-3.8

Sharekhan Research, Bloomberg

Summary

- Standalone PAT of Rs. 246 crore, down 84% q-o-q was 77% below our estimate due to earnings erosion for gas trading, EBITDA loss for petchem/LPG-LHC and weak gas transmission EBITDA owing to extra fuel costs.
- Gas trading/gas transmission EBITDA declined sharply by 99%/28% q-o-q to Rs. 3 crore/Rs. 723 crore because of large inventory loss of Rs. 1,100 crore in gas trading and extra Rs. 400 crore fuel cost for gas transmission. EBITDA loss for petchem segment stood at Rs. 210 due to lower sales volume/realisation and that for LPG-LHC at Rs. 6 crore on account of LPG pride fall and higher APM gas prices.
- The management expects PNGRB to approve revision in gas transmission tariff by April'23 and guided for 25% improvement in tariff based on revised tariff norms and guided to sustain gas trading annual EBITDA at Rs. 2,500 crore and LPG-LHC to benefit of Rs. 1000-1200 crore in case the APM gas price cap is approved by the government.
- We maintain a Hold rating on GAIL with a revised PT of Rs. 100 given limited upside potential from the CMP and earnings concern for its commodity businesses (petchem and gas trading).

GAIL (India) Limited's Q3FY23 standalone operating profit of Rs. 261 crore declined sharply by 93.8%/85.2% y-o-y/q-o-q and was 85% below ours/the street's estimate of Rs. 1,761 crore/Rs. 1,708 crore due to weaker-than-expected profitability/volume pressure as across all key business segments. Volume for petchem/gas trading/gas transmission segment were y-o-y/q-o-q as full effect of LNG supply disruptions from Gazprom are visible in Q3FY23. Gas trading segment posted an EBITDA of just Rs. 3 crore (versus Rs. 452 crore in Q2FY23) as it got impacted by massive inventory loss of Rs. 1,100 crore ($25/mmBtu decline in spot LNG price as of the quarter-end) on unsold LNG cargos and 3% q-o-q decline in gas trading volume to 90 mmscmd (below estimate of 92 mmscmd). EBITDA from gas transmission business declined sharply by 28% q-o-q to Rs. 723 crore due to extra fuel expenses of Rs. 400 crore given lower domestic gas allocation (0.45 mmscmd), while volumes were muted at 104 mmscmd (down 3.7% q-o-q). Petrochemical segment posted negative EBITDA of Rs. 210 crore on account decline in blended realisations (down Rs. 11700/tonne q-o-q) and continued lower sales volume of 65kmt (down 40% q-o-q) as plant operated at lower utilisation of 31% reduced LNG supplies. LPG-LHC segment performance was also weak with negative EBITDA of Rs. 6 crore (versus positive EBITDA of Rs. 524 crore in Q2FY23) because of lower LPG realisation (declined by Rs. 7300/tonne q-o-q) and higher domestic gas price (raised by 41% to $8.6/mmBtu. PAT at Rs. 246 crore (down 92.5% y-o-y; down 84% q-o-q) also significantly missed our/street estimate by 77%/79% due to weaker-than-expected performance across all key segments partially offset by higher-than-expected other income.

Key positives

- Management guided for Rs. 10/mmBtu (25% of existing tariff) improvement in gas pipeline tariff.

Key negatives

- Petchem/LPG-LHC posted EBITDA loss of Rs. 210 crore/Rs. 6 crore in Q3FY23.
- Gas trading EBITDA eroded by massive inventory loss of Rs. 1,100 crore; gas transmission affected by extra fuel expenses of Rs. 400 crore.

Management Commentary

- GAIL expects a Rs. 10/mmBtu (25% of current tariff) improvement in gas pipeline tariff based on revised tariff norms.
- Management guided to maintain EBITDA of Rs. 2,500 crore p.a. from gas trading segment despite volatile LNG prices.
- Petchem plant utilisation at 40% currently and management expects full utilization at LNG price of $16-17/mmBtu.
- Capping of APM gas price if implemented could add Rs. 1,000-1,200 crore to LPG-LHC EBITDA.
- Other updates – 1) Looking for alternative long term LNG contract given supply impact from Gazprom, 2) capex guidance of Rs. 8,000 crore for FY23 and 3) GAIL has gone to regulator to consider extra expenses of Rs. 400 crore for tariff revisions.

Revision in estimates – We have lowered our FY23 earnings estimate to factor weak 9MFY23 performance and have fined-tuned our FY24 earnings estimates. We have also introduced our FY25 earnings estimate in this report.

Our Call

Valuation – Maintain Hold with a revised PT of Rs. 100: Global gas supply crisis, volatile LNG prices and lower PE/LPG price creates earnings uncertainties for GAIL's major segments such as gas trading, petchem and LPG-LHC. We believe that normalization of earnings could take time given a volatile business environment for its commodity business. Hence, we maintain our Hold rating on GAIL with a revised PT of Rs. 100. At CMP, GAIL trades at 5.5x FY24E EV/EBITDA and 4.9x FY25E EV/EBITDA.

Key Risks

Faster-than-expected resolution of gas supply issue from Gazprom and a ramp-up of domestic gas supply could improve gas volume and is key upside risk. Difficulty is sourcing of LNG cargos at a reasonable price amid global gas supply crunch could act as earnings headwinds and is a key downside risk.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	91,626	1,46,376	1,33,362	1,44,672
OPM (%)	15.1	5.7	9.3	9.6
Adjusted PAT	10,364	5,957	8,735	9,679
% YoY growth	111.9	-42.5	46.6	10.8
Adjusted EPS (Rs.)	15.8	9.1	13.3	14.7
P/E (x)	6.0	10.5	7.1	6.5
P/B (x)	1.1	1.1	1.0	0.9
EV/EBITDA (x)	4.8	7.9	5.5	4.9
RoNW (%)	20.3	10.4	14.2	14.5
RoCE (%)	20.3	10.6	14.3	14.6

Source: Company; Sharekhan estimates

Large Q3 earnings miss; PAT erosion of 93% y-o-y due to loss in commodity businesses

Q3FY23 standalone operating profit of Rs. 261 crore declined sharply by 93.8%/85.2% y-o-y/q-o-q and was 85% below ours/the street's estimate of Rs. 1,761 crore/Rs. 1,708 crore due to weaker-than-expected profitability/volume pressure as across all key business segments. Volume for petchem/gas trading/gas transmission segment were y-o-y/q-o-q as full effect of LNG supply disruptions from Gazprom are visible in Q3FY23. Gas trading segment posted an EBITDA of just Rs. 3 crore (versus Rs. 452 crore in Q2FY23) as it got impacted by massive inventory loss of Rs. 1,100 crore ($25/mmBtu decline in spot LNG price as of the quarter-end) on unsold LNG cargos and 3% q-o-q decline in gas trading volume to 90 mmscmd (below estimate of 92 mmscmd). EBITDA from gas transmission business declined sharply by 28% q-o-q to Rs. 723 crore due to extra fuel expenses of Rs. 400 crore given lower domestic gas allocation (0.45 mmscmd), while volumes were muted at 104 mmscmd (down 3.7% q-o-q). Petrochemical segment posted negative EBITDA of Rs. 210 crore on account decline in blended realisations (down Rs. 11700/tonne q-o-q) and continued lower sales volume of 65kmt (down 40% q-o-q) as plant operated at lower utilisation of 31% reduced LNG supplies. LPG-LHC segment performance was also weak with negative EBITDA of Rs. 6 crore (versus positive EBITDA of Rs. 524 crore in Q2FY23) because of lower LPG realisation (declined by Rs. 7300/tonne q-o-q) and higher domestic gas price (raised by 41% to $8.6/mmBtu. PAT at Rs. 246 crore (down 92.5% y-o-y; down 84% q-o-q) also significantly missed our/street estimate by 77%/79% due to weaker-than-expected performance across all key segments partially offset by higher-than-expected other income.

Q3FY23 key conference call highlights

- **Gas transmission outlook –** GAIL has submitted tariff quotation with PNGRB based on revised transmission tariff parameters and expects Rs. 10/mmBtu (25% of current tariff) improvement in transmission pipeline tariff. In addition, a likely higher tariff (expected to double from current level of Rs. 65/mmBtu) for Jagdishpur-Dharma pipeline would also support tariffs.
- **Gas trading outlook –** The management guided for annual EBITDA of Rs. 2,500 crore and indicated that majority of inventory loss has been booked in Q3FY23. Looking for alternative long term LNG contract given supply impact from Gazprom.
- **Petchem outlook –** The management aims to operate petchem plant at full utilization at LNG price of $16-17/mmBtu. Currently petchem plant utilisation is at 40% as LNG supply from Gazprom continue to remain disrupted.
- **LPG-LHC outlook –** If capping of APM gas price at $6.5/mmBtu is implemented than LPG-LHC segment EBITDA would have benefit of Rs. 1000-1200 crore.
- **GAIL** has gone to regulator to consider extra expenses of Rs. 400 crore for tariff revision (would be spread across the economic life of the pipeline i.e. 2033).
- Massive inventory loss of Rs. 1100 crore was booked in gas trading business as spot LNG price has decline to ~$20/mmBtu as at the end of December 2022 as compared to high of $45/mmBtu at the end of Q2FY23.
- **Gazprom LNG supply update –** LNG supply disruption from Gazprom continues and company is in discussion with Gazprom to resume normal LNG supplies. However, management has not given any timeline for the normalized LNG supply from Gazprom.
- **GAIL Gas performance –** PAT increased to Rs. 87 crore in Q3FY23 versus Rs. 71 crore in Q2FY23 while volume remained flat q-o-q at 5.5 mmscmd.
- **Key project updates –** 1) The Mumbai-Nagpur section of Mumbai-Nagpur-Jharsuguda pipeline (1,755 kms) is expected to get completed by May-23, 2) Out of 3,384 km of the Jagdishpur-Haldia-Bokaro-Dhamra

Pipeline, ~50% of 1770 kms has been commissioned and remained part expected to be commissioned by Jun'23 , 3) tendering activities for PDHP plant is in full swing and plant is expected to get commissioned by April'25 and 4) PP plant at Pata is expected to commissioned by April 2024.

- **Other updates –** 1) capex guidance of Rs. 8,000 crore of capex for FY23 and has completed capex of Rs. 6,278 crore in 9MFY23 and 2) debt on the books was at Rs. 10,164 crore as on December 2022.

Results (standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenues	**35,365**	**25,770**	**37.2**	**38,479**	**-8.1**
Total Expenditure	35,104	21,542	63.0	36,714	-4.4
Operating profit	**261**	**4,228**	**-93.8**	**1,765**	**-85.2**
Other Income	689	652	5.7	799	-13.8
Interest	105	39	166.5	68	53.8
Depreciation	623	532	17.0	619	0.5
PBT	223	4,308	-94.8	1,876	-88.1
Tax	-23	1,020	NA	339	NA
Reported PAT	**246**	**3,288**	**-92.5**	**1,537**	**-84.0**
Equity Cap (cr)	658	658		658	
Reported EPS (Rs.)	0.4	5.0	-92.5	2.3	-84.0
Margins (%)			**BPS**		**BPS**
OPM	0.7	16.4	-1567	4.6	-385
Effective tax rate	-10.4	23.7	NA	18.1	NA
NPM	0.7	12.8	-1206	4.0	-330

Source: Company; Sharekhan Research

Segmental EBITDA Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Natural gas transmission	723	1,256	-42.4	1,010	-28.4
LPG transmission	108	96	12.5	130	-16.9
Natural gas trading	3	1,795	-99.8	452	-99.3
Petrochemicals	-210	490	NA	-210	NA
LPG and Liquid hydrocarbons	-6	875	NA	524	NA
Others	332	367	-9.5	658	-49.5

Source: Company; Sharekhan Research

Segment-wise volume performance

Segmental volumes	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Natural gas transmission (mmscmd)	104	114	-9.2	108	-3.7
LPG transmission (kmt)	1,101	1,057	4.2	1,100	0.1
Natural gas trading (mmscmd)	90	97	-6.9	93	-2.9
Petrochemicals (kmt)	65	217	-70.0	108	-39.8
LPG and Liquid hydrocarbons (kmt)	248	275	-9.8	231	7.4

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Regulatory push to drive gas demand, volatile spot LNG/LPG/HDPE price a near term concern**

Long-term growth outlook for gas transmission volumes of gas utilities remain intact supported by robust gas demand outlook driven by: 1) Higher demand from power, CGD, and fertiliser sectors and 2) Regulatory push for a shift to gas from polluting industrial/automobile fuels. In addition, the recent revision in gas pipeline tariff norms by the regulator bodes well for higher transmission tariff going for forward. However, near term headwinds persists in term of gas transmission volumes, due to global LNG supply disruption and likely weak gas demand from price sensitive Indian customers (especially power sector and industrial gas users). Additionally, a volatile spot LNG/LPG/HDPE price would keep the profitability of commodity business (like gas trading, petrochemical and LPG) under pressure.

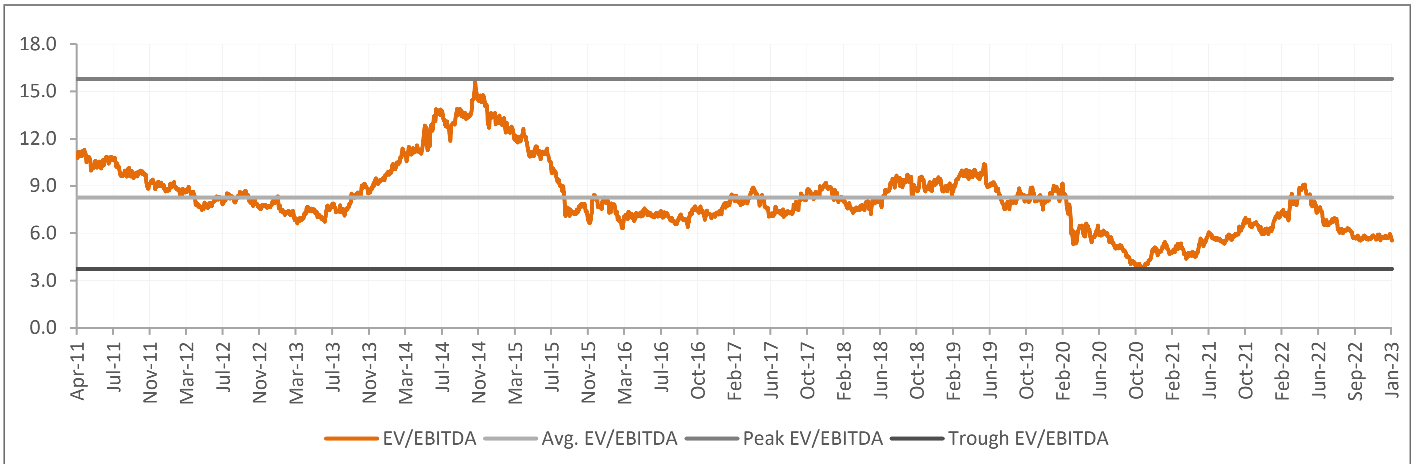
■ **Company Outlook – Near-term earnings headwinds due to gas supply concern**

The Russia-Ukraine crisis led to global gas supply distortions leading to high spot LNG price and thus companies taking measures to ensure gas supply to Europe. This would mean lower LNG supply for GAIL (as Gazprom stops 2.5 mtpa LNG supply) and creates volume headwinds for GAIL's gas transmission, gas marketing and petchem business. Thus, we expect GAIL's PAT to decline sharply by 43% y-o-y in FY23.

■ **Valuation – Maintain Hold with a revised PT of Rs. 100**

Global gas supply crisis, volatile LNG prices and lower PE/LPG price creates earnings uncertainties for GAIL's major segments such as gas trading, petchem and LPG-LHC. We believe that normalization of earnings could take time given a volatile business environment for its commodity business. Hence, we maintain our Hold rating on GAIL with a revised PT of Rs. 100. At CMP, GAIL trades at 5.5x FY24E EV/EBITDA and 4.9x FY25E EV/EBITDA.

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 ~14,617 km of gas pipelines as on September 30, 2022. 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 long term 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. However, recent global gas supply disruptions and volatile LNG price create volume/margin led earnings headwinds for the company.

Key Risks

- Faster-than-expected resolution of gas supply issue from Gazprom and ramp-up of domestic gas supply could improve gas volume and is key upside risk.
- Difficulty in sourcing of LNG cargos at a reasonable price amid global gas supply crunch could act as earnings headwinds and is a key downside risk.

Additional Data

Key management personnel

Sandeep Kumar Gupta	Chairman and MD
Rakesh Kumar Jain	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 (old data)

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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