Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

GAIL (India) Ltd

Core gas transmission biz on firm footing

Oil & Gas	Sharekhan code: GAIL
Reco/View: Buy ↔	CMP: Rs. 166 / Price Target: Rs. 190 ↑

↑ 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 29.23

Updated Aug 08, 2023

Medium Risk

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

Source: Morningstar

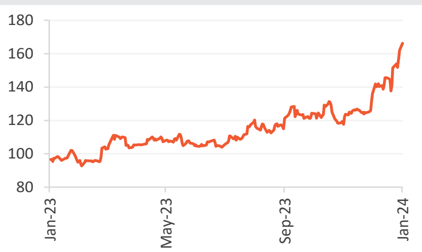
Company details

Market cap:	Rs. 1,09,344 cr
52-week high/low:	Rs. 169/91
NSE volume: (No of shares)	177.4 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	316.2 cr

Shareholding (%)

Promoters	51.9
FII	14.8
DII	19.1
Others	14.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.2	34.1	56.3	72.2
Relative to Sensex	12.2	23.8	45.5	54.0

Sharekhan Research, Bloomberg

Summary

- We reiterate a Buy rating on GAIL with a raised PT of Rs. 190 given our expectation of strong earnings growth, potential improvement in earnings quality (higher earnings share of core gas transmission + RoE of 15.8% in FY26E) and reasonable valuation of 7.5x FY26E EV/EBITDA, 9.8x FY26E EPS and 1.5x FY26E P/BV.
- The gas transmission business has multiple growth drivers in terms of volume growth/tariff improvement. We expect 9% CAGR over FY23-26E for gas transmission volume and reach 140 mmscmd in FY26E.
- Petchem segment expected to turnaround gradually given improved plant utilisation, likely better HDPE prices as capacity addition to lag demand growth and soft LNG prices.
- Likely monetisation of stake in GAIL Gas (wholly owned subsidiary of GAIL) could unlock value and add ~8% (or ~Rs. 15/share) to GAIL's valuation.

GAIL's gas transmission business to benefit from strong volumes (aided by rising gas supplies + soft LNG prices) and petchem business would witness a turnaround supported by higher plant utilization as well gradual improvement in HDPE prices. With strong growth for the core gas transmission business, we expect its share in EBITDA to increase going forward and the same would improve earnings quality. Overall, we expect GAIL's EBITDA/PAT to clock robust 32%/28% CAGR over FY23-26E (which is one of best among earnings growth among oil & gas PSUs) along with marked improvement in its RoE to 15.8% in FY26E (versus 9.5% in FY23). Valuation seems reasonable at 7.5x FY26E EV/EBITDA and the stock offers a healthy dividend yield of ~3-4%. Hence, we maintain our Buy rating on GAIL with an increased PT of Rs. 190.

- **Gas transmission – Strong volume growth tailwinds; expect better tariffs:** Global LNG prices are expected to remain soft as large LNG capacities are likely to get commissioned in the US and Qatar. This coupled with rising domestic gas supplies (from RIL/ONGC/Oil India), ramp-up of new re-gas terminals and higher gas demand (from CGD, fertilisers and petrochemicals, power) makes GAIL's transmission business well placed to sustain strong volume growth over next couple of years. We thus model robust 9% CAGR in GAIL's gas transmission volume over FY23-26E and expect it to reach 140 mmscmd in FY26E. Moreover, GAIL would benefit from higher gas transmission tariffs, given implementation of unified tariffs, with effect from April 1, 2023. Improved gas transmission volume outlook and better tariff would drive 34% CAGR in gas transmission EBITDA over FY23-26E.
- **Petchem business to turnaround as utilization/prices to improve; capex to expand product portfolio:** GAIL's petchem segment reported EBITDA loss of Rs. 508 crore in FY23 as its petchem plant operated at only a 50% utilisation due to LNG supply disruptions from Gazprom and elevated spot LNG prices. We expect GAIL's petchem business to turnaround (GAIL aims to reach EBITDA break-even by end-FY24) as plant utilisation improves (H1FY24 at 74%) and HDPE price likely to improve going forward as capacity addition to lag demand growth. Moreover, GAIL is undergoing capex for PDH-PP (500 KTA at an estimated capex of Rs. 113 billion and commissioning by April 2025) and PP (60 KTPA at an estimated capex of Rs. 13 bn and commissioned by July 2024) and the same would expand product portfolio and improve earnings predictability given diversification of feedstock to both gas and propane.
- **Potential monetization of stake in GAIL Gas – to unlock value for GAIL:** GAIL Gas is wholly owned subsidiary of GAIL and is engaged in CGD business (operating and executing CGD projects in 16 GAs; also has 6 JVs for CGD projects in 9 GAs). In FY23, GAIL Gas recorded gas sales volume/EBITDA/PAT of 5.7 mmscmd/Rs. 505 crore/Rs. 283 crore. GAIL is evaluating for monetization of CGD assets and the same help to unlock value from its stake in GAIL Gas.

Our Call

Valuation – Maintain Buy on GAIL with a revised PT of Rs. 190: We have fine-tuned our FY24-26 earnings estimate. We expect GAIL to post a strong earnings recovery (expect EBITDA/PAT CAGR of 32%/28% over FY23-26E) across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Moreover, its earnings quality would improve with an increase in EBITDA share from its core gas transmission business. Valuation of 7.5x FY26E EV/EBITDA is reasonable given a discount to historical average of 8.4x, expectation of a strong earnings growth, improvement in RoE to 15.8% (versus only 9.5% in FY23) and a healthy dividend yield of ~3-4%. Hence, we maintain a Buy rating on GAIL with a revised PT of Rs. 190 (reflects rollover of valuation multiple to FY26 earnings estimate).

Key Risks

1) LNG supply concerns and a lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilisation; 2) A sharp decline in LNG prices and international oil prices could impact profitability of gas trading, petrochemical, and LPG-LHC segments and 3) Sustained losses in petchem segment in case of volatility in HDPE and spot LNG prices.

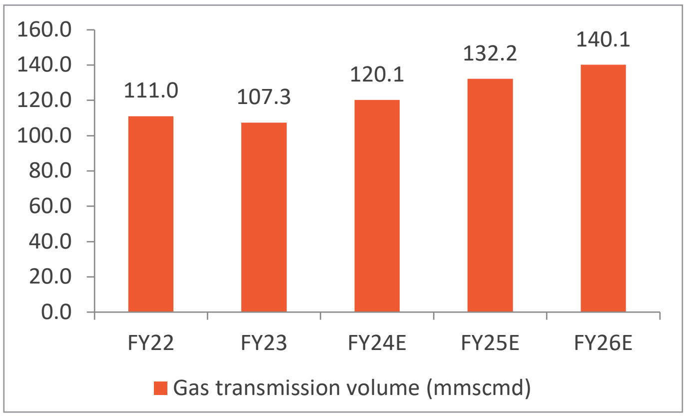
Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	91,626	1,44,250	1,37,258	1,49,821	1,60,422
OPM (%)	15.1	4.6	8.2	9.1	9.6
Adjusted PAT	10,364	5,302	8,327	9,952	11,202
% YoY growth	111.9	-48.8	57.1	19.5	12.6
Adjusted EPS (Rs)	15.8	8.1	12.7	15.1	17.0
P/E (x)	10.6	20.6	13.1	11.0	9.8
P/B (x)	2.0	2.0	1.8	1.6	1.5
EV/EBITDA (x)	8.2	18.4	10.7	8.7	7.5
RoNW (%)	20.3	9.5	14.3	15.5	15.8
RoCE (%)	20.3	8.9	13.4	15.0	15.7

Source: Company; Sharekhan estimates

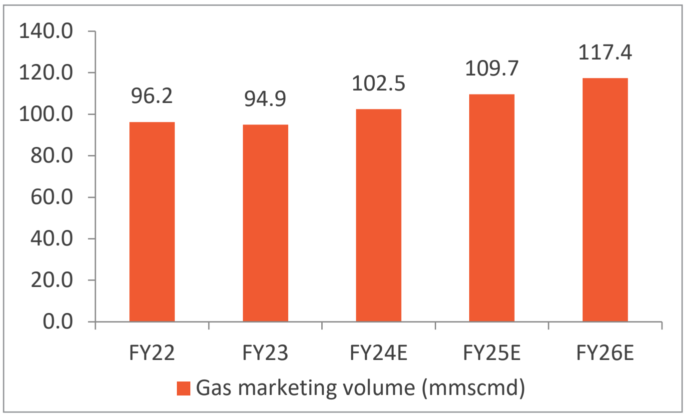
Financials in charts

Robust gas transmission volume growth outlook



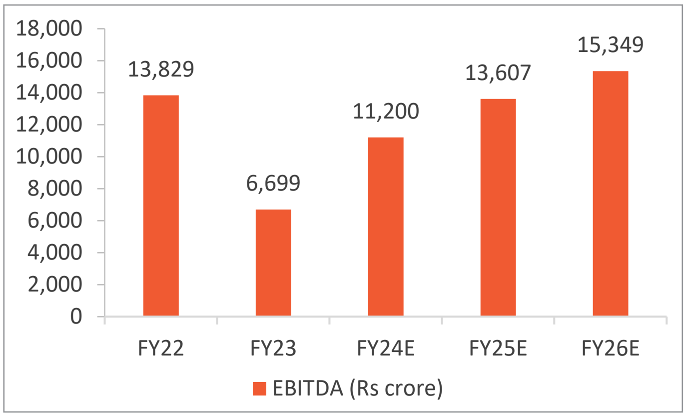
Source: Company, Sharekhan Research

Gas marketing volume to post 7% CAGR over FY23-26E



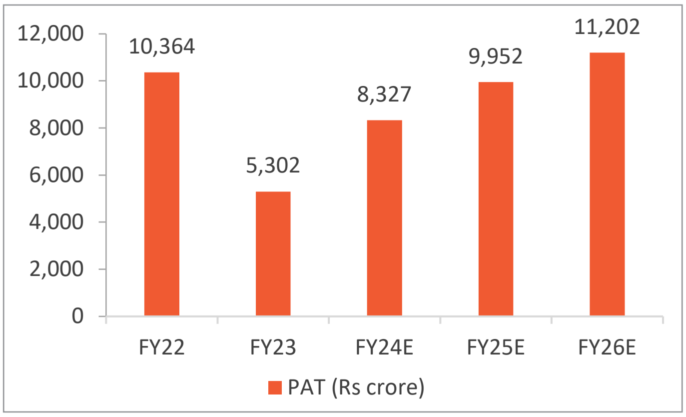
Source: Company, Sharekhan Research

EBITDA to clock 32% CAGR over FY23-26E



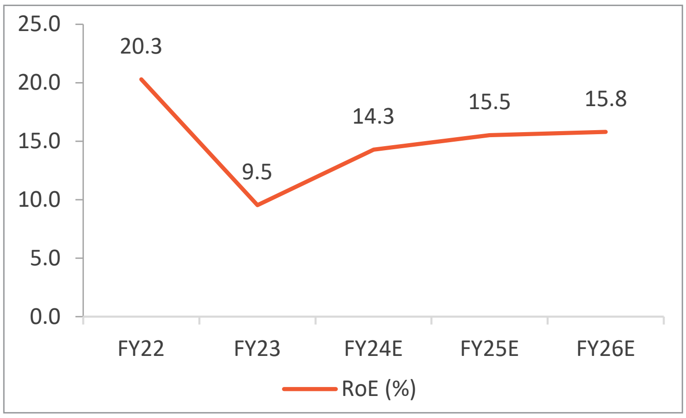
Source: Company, Sharekhan Research

PAT to clock 28% CAGR over FY23-26E



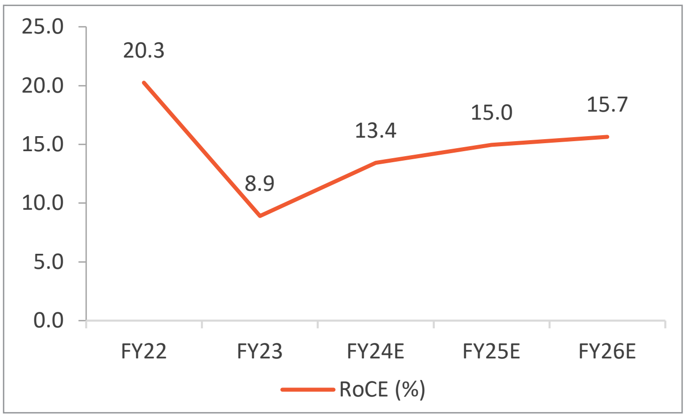
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



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 remains intact, supported by a 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 regulator's recent revision in gas pipeline tariff norms bodes well for higher transmission tariffs going forward. However, volatile spot LNG/LPG/HDPE price remains a key concern for the profitability of commodity business (like gas trading, petrochemical and LPG).

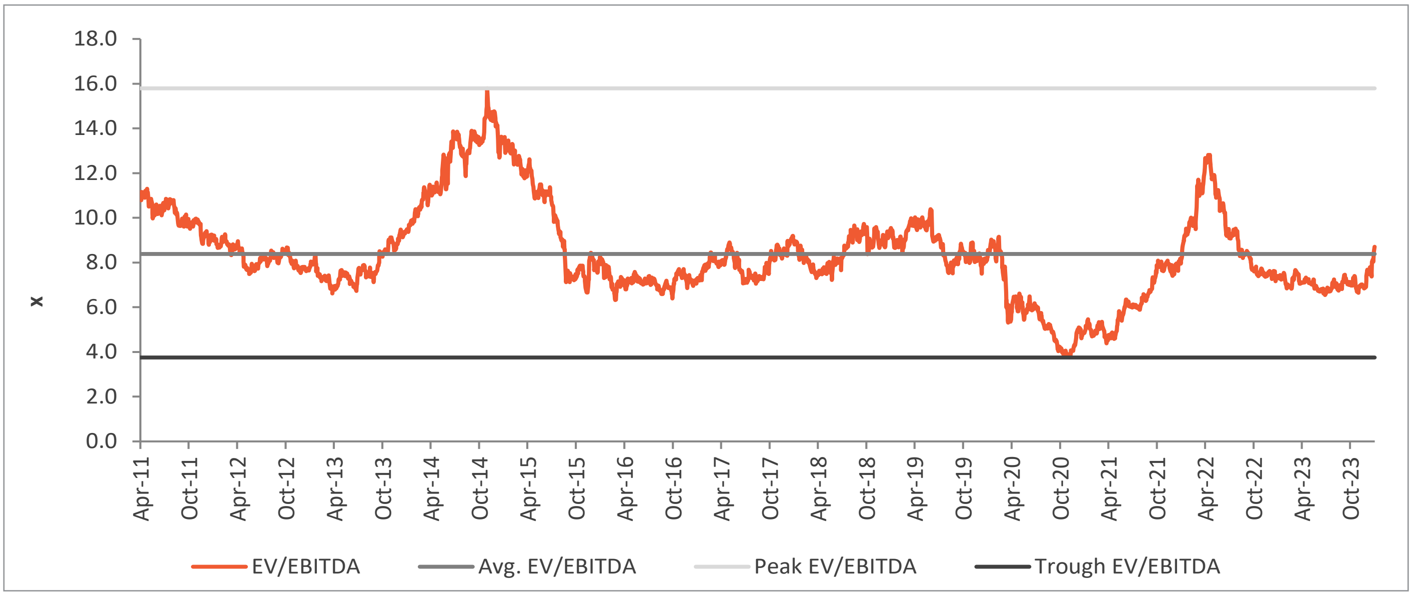
■ **Company outlook - Improving earnings outlook as gas supply concern eases**

After a dismal show in FY2023, we expect GAIL's earnings to recover strongly in FY2024, supported by an improving outlook across its business segments. Gas transmission would benefit from higher tariff/volume; petchem to turnaround on improved LNG supply and lower gas cost, while LPG-LPG margin is expected to improve from the APM gas price cap. Management expects trading EBITDA of Rs. 4,000-4,500 crore in FY2024E/FY2025E. Overall, we expect a 28% PAT CAGR for GAIL over FY2023-FY2026E.

■ **Valuation - Maintain Buy on GAIL with a revised PT of Rs. 190**

We have fine-tuned our FY24-26 earnings estimate. We expect GAIL to post a strong earnings recovery (expect EBITDA/PAT CAGR of 32%/28% over FY23-26E) across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Moreover, its earnings quality would improve with an increase in EBITDA share from its core gas transmission business. Valuation of 7.5x FY26E EV/EBITDA is reasonable given a discount to historical average of 8.4x, expectation of a strong earnings growth, improvement in RoE to 15.8% (versus only 9.5% in FY23) and a healthy dividend yield of ~3-4%. Hence, we maintain a Buy rating on GAIL with a revised PT of Rs. 190 (reflects rollover of valuation multiple to FY26 earnings estimate).

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 and markets two-thirds of gas sold in India. 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 the city gas distribution (CGD) businessstakes in CGD companies or through subsidiaries. GAIL also owns LNG import terminals.

Investment theme

Strong long-term gas demand supported by a 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. We expect GAIL's earnings to witness a strong recovery in FY24, supported by an improving outlook across its business segments, given the normalisation of global LNG supply and prices. GAIL's valuation is reasonable, and the stock offers a healthy divided yield.

Key Risks

- Continued LNG supply concern and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilization,
- A sharp decline in LNG price and international oil prices could affect the profitability of gas trading, petrochemical, and LPG-LHC segments.
- Sustained losses in the petchem segment in case of volatility in spot LNG and HDPE price.

Additional Data

Key management personnel

Sandeep Kumar Gupta	Chairman and MD
Rakesh Kumar Jain	Director (Finance)
M.V. Iyer	Director (Marketing)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.1
2	SBI Funds Management Ltd	2.34
3	Vanguard Group Inc/The	1.89
4	HDFC Asset Management Co Ltd	1.61
5	BlackRock Inc	1.13
6	Norges Bank	0.92
7	ICICI Prudential Asset Management	0.85
8	FMR LLC	0.63
9	Kotak Mahindra Asset Management Co	0.55
10	DSP Investment Managers Pvt Ltd	0.45

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

Sharekhan

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200 / 022-69920600