Sharekhan by BNP PARIBAS

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Stock Update

Result Update

GAIL (India) Ltd

Robust Q3; strong growth outlook

Oil & Gas	Sharekhan code: GAIL
Reco/View: Buy ↔	CMP: Rs. 172 / Price Target: Rs. 200 ↑

↑ 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		↔	

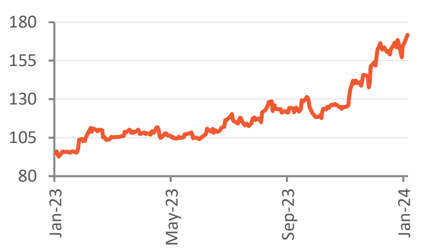
Company details

Market cap:	Rs. 1,12,894 cr
52-week high/low:	Rs. 175 / 91
NSE volume: (No of shares)	201.4 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	316.2 cr

Shareholding (%)

Promoters	51.9
FII	14.2
DII	19.4
Others	14.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.2	44.7	44.3	80.8
Relative to Sensex	3.7	32.5	36.1	59.9

Sharekhan Research, Bloomberg

Summary

- Standalone PAT of Rs. 2,843 crore, up 18% q-o-q was 29% above our estimate led by sharp earnings beat from gas trading/petchem segments, higher other income and rise in interest cost/tax rate offsetting slightly subdued gas transmission.
- Petchem segment turned EBITDA positive led by higher utilization, better absorption of fixed cost and lower gas cost. GAIL trading benefited from continued strong marketing margins, while LPG-LHC EBITDA growth was led by higher realisations.
- Management upped FY24 gas marketing EBITDA guidance to Rs. 5,500 crore and expect it to be at Rs. 4,000 crore/Rs. 4,500 crore for FY25/FY26. GAIL aims for reasonable petchem profits in FY25; strong gas transmission volume growth to continue.
- We reiterate our Buy rating with a revised PT of Rs. 200 given our expectation of strong earnings growth and reasonable valuation of 7.7x FY26E EV/EBITDA, 10x FY26E EPS and 1.5x FY26E P/BV.

Q3FY24 standalone operating profit was robust at Rs. 3,823 crore, up 9% q-o-q and 22% above our estimate led by stronger-than-expected performance from gas trading and turnaround of petchem business. Gas trading business continued its growth momentum with 6% q-o-q rise in its EBITDA to Rs. 2073 crore, which was significantly above our estimate strength implied gas marketing margin (up 4% q-o-q) and marginal 1% growth in gas marketing volume to 98 mmscmd. Strong marketing segment performance was supported optimization of gas cost through time swap, destination swap and shipping optimization. Petchem segment turned EBITDA positive at Rs205 crore (versus EBITDA loss of Rs. 38 crore in Q2FY24) reflecting higher petchem volume (up 28% q-o-q to 215kt) and optimization of gas cost. LPG-LHC segment posted EBITDA of Rs. 280 crore (versus only Rs. 5 crore in Q2FY24) led by higher LPG-LHC realisations (up 32% q-o-q). However, gas transmission segment EBITDA declined by 5% q-o-q to Rs 1561 crore due to higher cost while gas transmission volume stood at 122 mmscmd (up 1% q-o-q). Standalone PAT at Rs. 2,843 crore (up 18% q-o-q) was 29% above our estimate reflecting strong performance from gas trading/petchem/LPG-LHC segments, higher dividend income, lower interest cost and tax rate.

Key positives

- Sharp EBITDA beat from gas trading and petchem segments.
- Declared interim dividend of Rs. 5.5/share, which implies a 3% yield on CMP.

Key negatives

- Gas transmission EBITDA declined by 5% q-o-q.

Management Commentary

- Gas transmission volume guidance is at 120 mmscmd with exit rate of 123-124 mmscmd for Q4FY24. Guidance of 12-15 mmscmd y-o-y increase in gas transmission for next three years.
- Raised gas trading EBITDA guidance to Rs5500 crore for FY24 (versus Rs. 4,000 crore earlier) for FY2024 and guided for Rs. 4000 crore/Rs. 4500 crore for FY25/FY26. Gas marketing volume growth of 5-6% achievable.
- Petchem segment to be at break-even on annual basis in FY24 aims for reasonable profit in FY24 at gas cost of $8-9/bbl even at current petchem realisation.
- Other updates – 1) FY25 capex guidance of Rs17000 crore and have spent Rs 4192 crore, 2) internally evaluating value unlocking options for CGD business and 3) working on hydrogen plant on pilot basis, 4) PDH-PP plant of 500 ktpa is expected to be commissioned by April 2025.

Revision in estimates – We have increased our FY24 earnings estimate to factor strong 9MFY24 performance and have fine-tuned our FY2025-FY2026 earnings estimates.

Our Call

Valuation – Maintain Buy on GAIL with a revised PT of Rs. 200: We expect GAIL to post a strong earnings recovery across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Valuation of 7.7x its FY2026E EV/EBITDA given expectation of a strong earnings growth and a healthy dividend yield of 3-4%. Hence, we maintain our Buy rating on GAIL with a revised price target (PT) of Rs. 200.

Key Risks

1) LNG supply concerns and 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 hit profitability of gas trading, petrochemical, and LPG-LHC segments, and 3) Sustained losses in the 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	1,33,109	1,48,944	1,59,555
OPM (%)	15.1	4.6	10.1	9.2	9.7
Adjusted PAT	10,364	5,302	10,038	9,993	11,248
% YoY growth	111.9	-48.8	89.3	-0.5	12.6
Adjusted EPS (Rs)	15.8	8.1	15.3	15.2	17.1
P/E (x)	10.9	21.3	11.2	11.3	10.0
P/B (x)	2.0	2.0	1.8	1.6	1.5
EV/EBITDA (x)	8.5	18.9	9.0	8.9	7.7
RoNW (%)	20.3	9.5	17.1	15.3	15.6
RoCE (%)	20.3	8.9	16.0	14.8	15.5

Source: Company; Sharekhan estimates

Strong Q3; gas trading/petchem perform well

Robust Q3FY24 standalone operating profit of Rs. 3,823 crore, up 9% q-o-q and 22% above our estimate, was led by stronger-than-expected performance from gas trading and turnaround of petchem business. Gas trading business continued its growth momentum with 6% q-o-q rise in its EBITDA to Rs. 2073 crore, which was significantly above our estimate strength implied gas marketing margin (up 4% q-o-q) and marginal 1% growth in gas marketing volume to 98 mmscmd. Petchem segment turned EBITDA positive at Rs205 crore (versus EBITDA loss of Rs38 crore in Q2FY24) reflecting higher petchem volumes (up 28% q-o-q to 215kt) and optimization of gas cost. LPG-LHC segment posted EBITDA of Rs280 crore (versus only Rs5 crore in Q2FY24) led by higher LPG-LHC realisations (up 32% q-o-q). However, gas transmission segment EBITDA declined by 5% q-o-q to Rs1561 crore due to higher cost while gas transmission volume stood at 122 mmscmd (up 1% q-o-q). Standalone PAT at Rs2,843 crore (up 18% q-o-q) was 29% above our estimate reflecting strong performance from gas trading/petchem/LPG-LHC segments, higher other income, lower interest cost and tax rate.

Q3FY2024 earnings conference call highlights

- **Gas marketing business guidance:** Management expects gas marketing margin to exceed Rs 5500 crore level by the end of FY24. Management also expects to generate gas marketing margin of Rs 4000 crore and Rs 4500 crore for FY25 & FY26 respectively. Management also believe that gas marketing volume will grow by 5-6%.
- **Petrochemical business:** This business segment has achieved 100% capacity utilisation. Management is targeting to breakeven in this segment on annual basis in FY24, which will be supported by optimization of gas price. Management expects this segment to generate reasonable profit in FY25. Gas prices of $8-9/mmbtu are good prices to make profits at current petchem prices.
- **Gas transmission:** GAIL plans to achieve average daily transmission of 120 mmscmd with the exit rate of 123 mmscmd for FY24. During next 2 to 3 years, management believe that transmission volume will increase by 12-15 mmscmd on year-on-year basis. In LPG-LNG business, management expects better pricing and hedging of LPG product would help improve margins.
- **Capex guidance:** Company plans to incur capex of Rs 17,000 crore in FY25. In FY25, company plans to spend Rs 3000 crore on pipeline projects, Rs 4400 crore on Petrochemicals, ~ Rs 750 crore on operational Capex and ~ Rs 5000 crore in equity contributions towards JVs.
- **Value unlocking:** GAIL is currently evaluation value unlocking opportunity in CGD business and will take decision at appropriate time.
- **Hydrogen plant:** The company plans to set up pilot hydrogen plant at one if its units.

Results (Standalone) Rs cr

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Revenues	**34,236**	**35,365**	**-3.2**	**31,807**	**7.6**
Total Expenditure	30,414	35,104	-13.4	28,315	7.4
Operating profit	**3,823**	**261**	**1362.7**	**3,491**	**9.5**
Other Income	812	689	17.9	561	44.8
Interest	156	105	49.0	172	-9.0
Depreciation	784	623	26.0	750	4.5
PBT	3,694	223	1559.0	3,130	18.0
Tax	851	-23	NA	725	17.4
Reported PAT	2,843	246	1056.8	2,405	18.2
Equity Cap (cr)	658	658		658	
Reported EPS (Rs)	4.3	0.4	1056.8	3.7	18.2
Margins (%)			**BPS**		**BPS**
OPM	11.2	0.7	1043	11.0	19
Tax rate	23.0	-10.4	NA	23.2	-12
NPM	8.3	0.7	761	7.6	74

Source: Company; Sharekhan Research

Segmental EBITDA Rs cr

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Natural gas transmission	1,561	723	115.9	1,650	-5.4
LPG transmission	101	108	-6.5	104	-2.9
Natural gas trading	2,073	3	NA	1,953	6.1
Petrochemicals	205	-210	-197.6	-38	NA
LPG and Liquid hydrocarbons	280	-6	NA	5	NA
Others	415	332	25.0	378	9.8
Total EBITDA	**4,635**	**950**	**387.9**	**4,052**	**14.4**

Source: Company; Sharekhan Research

Segment-wise volume performance

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Natural gas transmission (mmscmd)	122	104	17.2	120	1.0
LPG transmission (kmt)	1,095	1,101	-0.5	1,114	-1.7
Natural gas trading (mmscmd)	98	90	9.2	97	1.2
Petrochemicals (kmt)	215	65	230.8	168	28.0
LPG and Liquid hydrocarbons (kmt)	249	248	0.4	242	2.9

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

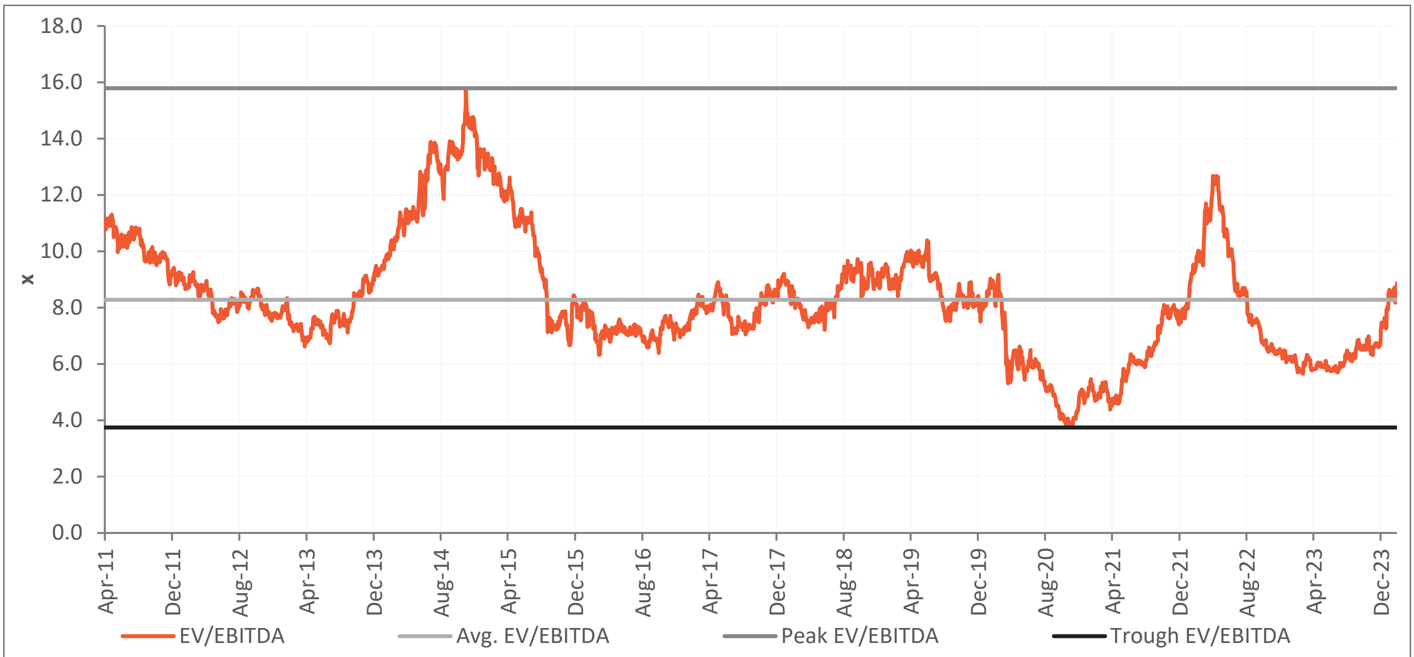
■ **Company Outlook – Improving earnings outlook as gas supply concern eases**

After a dismal show in FY2023, we expect GAIL's earnings to witness a strong recovery 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. 5,500 crore/Rs. 4,000 crore/4,500 crore in FY2024EFY2025E/FY2026E. Overall, we expect a 28% PAT CAGR for GAIL over FY2023-FY2026E.

■ **Valuation – Maintain Buy on GAIL with a revised PT of Rs. 200**

We expect GAIL to post a strong earnings recovery across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Valuation of 7.7x its FY2026E EV/EBITDA given expectation of a strong earnings growth and a healthy dividend yield of 3-4%. Hence, we maintain our Buy rating on GAIL with a revised price target (PT) of Rs. 200.

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) business with stakes 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 concerns and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilisation.
- A sharp decline in LNG price and international oil prices could affect 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)
Sanjay Kumar	Director (Marketing)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	7.46
2	SBI Funds Management Ltd	2.44
3	BlackRock Inc	1.63
4	Vanguard Group Inc/The	1.62
5	HDFC Asset Management Co Ltd	1.24
6	Kotak Mahindra Asset Management Co	1.05
7	ICICI Prudential Asset Management	0.98
8	Norges Bank	0.92
9	Quant Money Managers Ltd	0.75
10	DSP Investment Managers Pvt Ltd	0.67

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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Other registrations of 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.

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