

BUY

TP: Rs 175 | ▲ 41%

GAIL

Oil & Gas

12 August 2019

Pricing in the worst case

GAIL's Q1FY20 PAT/EBITDA surpassed estimates at Rs 13bn/Rs 23bn (+2.2%/flat YoY). Operationally, gross margins outperformed across segments, barring petchem. Key Q1 highlights: (a) gas trading EBITDA surged 56% YoY, (b) gas transmission volumes dipped 1.5% YoY, and (c) LPG EBITDA outperformed. We reduce FY20/FY21 earnings by 17%/15% as the cyclical downturn compresses LPG/petchem margins. Our TP changes to Rs 175 (from Rs 245) as we roll over to Sep'21 valuations.

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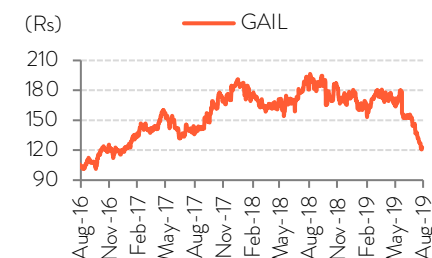
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Buoyant gas transmission volume outlook: While Q1 gas transmission volumes were lower than expected at ~105mmscmd (-1.5% YoY), tariffs were higher at Rs 1.54/scm (+15% YoY). New tariffs announced recently for HVJ and other pipeline networks are effective from Jul'19, the impact of which will be visible from Q2FY20. We remain positive on GAIL's volume outlook supported by (a) improving LNG offtake potential from new regasification capacities (PLNG Dahej to add ~6mmscmd from Q2FY20), and (b) incremental domestic gas production (ONGC/RIL: 20-30mmscmd by FY22).

Ticker/Price	GAIL IN/Rs 124
Market cap	US\$ 78.9bn
Shares o/s	45,101mn
3M ADV	US\$ 12.7mn
52wk high/low	Rs 200/Rs 120
Promoter/FPI/DII	53%/20%/27%

Source: NSE

STOCK PERFORMANCE



Source: NSE

Gas trading and cyclicals could revive: Q1 gas trading EBITDA at Rs 8.6bn (+56% YoY) surged on higher margins from spot LNG besides continuing benefits of hedges/swaps for US LNG volumes. Management indicated that earnings could sustain at this level until FY22 if spot LNG prices remain low. Trading volumes (96mmscmd in Q1) could also improve from Q2 given higher LNG offtake, especially from PLNG's new expanded capacity (~9mmscmd).

Reiterate BUY: At 8.3x FY21E EPS, GAIL offers attractive risk-reward, pricing in most of the concerns. Management continues to deny the possibility of a split in business segments, but this event appears to be priced in. Our TP of Rs 175 builds in worst-case assumptions across segments.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	46,000	63,525	60,998	67,132	71,102
Adj. EPS (Rs)	10.2	14.1	13.5	14.9	15.8
Adj. EPS growth (%)	43.1	38.1	(4.0)	10.1	5.9
Adj. ROAE (%)	11.7	15.1	13.6	14.0	13.8
Adj. P/E (x)	12.1	8.8	9.2	8.3	7.9
EV/EBITDA (x)	73.4	58.3	53.2	46.4	43.5

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	1,83,106	1,72,986	5.9	1,87,634	(2.4)
Purchase of traded goods	1,32,476	1,30,223	1.7	1,36,034	(2.6)
% of sales	72.3	75.3	-	72.5	-
Other expenditure	28,041	20,063	39.8	34,759	(19.3)
% of sales	15.3	11.6	-	18.5	-
EBITDA	22,590	22,700	(0.5)	16,841	34.1
EBITDA margin (%)	12.3	13.1	-	9.0	-
Depreciation and amortisation	4,057	3,789	7.1	4,574	(11.3)
EBIT	18,533	18,911	(2.0)	12,267	51.1
Interest	239	441	(45.8)	263	(9.2)
Other income	1,512	932	62.1	8,659	(82.5)
PBT	19,805	19,403	2.1	17,399	13.8
Provision for tax	6,930	6,810	1.8	6,177	12.2
PAT	12,875	12,593	2.2	14,486	(11.1)
NPM (%)	7.0	7.3	-	7.7	-
Reported EPS (Rs)	5.7	5.6	2.2	6.4	(11.1)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT-WISE PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Natural Gas Transmission					
Revenue	14,797	13,115	12.8	14,642	1.1
Volume (mmscmd)	105.41	107.03	(1.5)	109.15	(3.4)
Realisation (Rs/scm)	1.54	1.35	14.6	1.49	3.5
EBITDA	10,680	9,080	17.6	10,280	3.9
PBIT	8,595	7,028	22.3	7,729	11.2
LPG Transmission					
Revenue	1,346	1,410	(4.5)	1,768	(23.9)
Volume ('000 MT)	827	901	(8.2)	1,023	(19.2)
Realisation (Rs/MT)	1,627	1,565	4.0	1,728	(5.8)
EBITDA	760	800	(5.0)	1,090	(30.3)
PBIT	616	654	(5.9)	941	(34.5)
Natural Gas Trading					
Revenue	1,54,613	1,40,347	10.2	1,54,541	0.0
Volume (mmscmd)	96.55	97.16	(0.6)	98.42	(1.9)
Realisation (Rs/scm)	17.60	15.87	10.9	17.45	0.9
EBITDA	8,610	5,510	56.3	5,880	46.4
PBIT	8,505	5,513	54.3	5,875	44.8
Petrochemicals					
Revenue	11,128	16,134	(31.0)	17,190	(35.3)
Volume ('000 MT)	136	166	(18.1)	213	(36.2)
Realisation (Rs/MT)	81,821	97,192	(15.8)	80,702	1.4
Realisation (US\$/MT)	1,176	1,450	(18.9)	1,145	2.7
EBITDA	(1,170)	3,130	-	890	-
PBIT (US\$/MT)	(240)	187	-	(13)	-
LPG and Liquid HC					
Revenue	11,457	10,725	6.8	11,219	2.1
Volume ('000 MT)	296	314	(5.7)	335	(11.6)
Realisation (US\$/MT)	556	510	9.1	475	17.1
EBITDA	5,460	5,460	-	4,520	20.8
PBIT	5,108	5,301	(3.6)	4,162	22.7
Others					
Revenue	2,760	2,292	20.4	2,701	2.2
EBITDA	(60)	(350)	(82.9)	(420)	85.7
PBIT	1,510	847	78.2	899	68.1
Total Revenues	1,96,100	1,84,023	6.6	2,02,060	(2.9)

Source: Company, BOBCAPS Research

Earnings call highlights

■ Gas transmission

- Volumes declined ~4mmscmd QoQ due to shutdowns at fertiliser units.
- Revival to ~115mmscmd levels could occur from Q2FY20 as fertiliser units resume operations and offtake of LNG rises from PLNG's incremental 2.5mmtpa capacity at Dahej (currently operating at ~100%).
- Management will not contest the recently announced tariffs for some critical pipeline networks (HVJ, DVPL, among others) in the appellate tribunal. The impact of these tariffs would be visible from Q2FY20.
- The Kochi-Mangalore pipeline is being commissioned in phases. The Urja Ganga pipeline network project is on track for commissioning in two phases – Dec'20 (phase 1) and Dec'21 (phase 2).

■ Gas trading

- Out of 96mmscmd of gas trading volumes, 43mmscmd is domestic (APM gas), 22mmscmd is RLNG (Dahej), 12.4mmscmd is being sold internationally (US LNG), 5.5mmscmd of US LNG is being sold in India, and ~13mmscmd is other domestic gas.
- Close to 95% of LNG cargos from the US contract have been hedged until FY22.
- Incremental domestic gas production (~30mmscmd by FY23) from ONGC/RIL would be available on tendered basis and hence may not entirely become a part of gas trading volumes for GAIL

■ Others

- Petchem volumes at 136ktmt (-18% YoY, ~70% utilisation) were lower due to a maintenance shutdown. This should normalise from Q2FY20.
- Management continues to deny rumours of a potential split in business segments and insists that no such proposals are under formal discussion.
- Capex in Q1FY20 was at ~Rs 8.8bn (mostly on pipelines).

Valuation methodology

We reduce FY20/FY21 earnings by 17%/15% as the cyclical downturn compresses LPG and petchem margins. Post earnings revision and roll forward to Sep'21 valuations, our SOTP target price changes to Rs 175 (from Rs 245). Our newly introduced FY22 estimates pencil in earnings at Rs 16/sh (+6% YoY).

At 8.3x FY21E EPS, GAIL offers attractive risk-reward and is pricing in most of the concerns related to volumes. Management continues to deny the possibility of a split in business segments, but this event appears to be priced in. We note that our TP of Rs 175 builds in worst-case assumptions across segments.

Key changes to our assumptions:

- gas transmission tariffs assumed to be flat over the DCF period at Rs 1.5/scm (from 5% escalation every year),
- international PE prices revised down to US\$ 950/1,000 for FY20/FY21 (from US\$ 1,100 earlier), and
- LPG prices revised down to US\$ 450/500 (from US\$ 600/650) for FY20/FY21.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	911,454	626,416	(31.3)	1,021,592	724,423	(29.1)	794,785
EBITDA	120,872	104,847	(13.3)	135,891	120,553	(11.3)	129,109
EBITDA margin (%)	13.3	16.7	-	13.3	16.6	-	16.2
PAT	73,410	60,998	(16.9)	79,196	67,132	(15.2)	71,102
PAT margin (%)	8.1	9.7	-	7.8	9.3	-	8.9
EPS (Rs)	16.3	13.5	(17.1)	17.6	14.9	(15.4)	15.8

Source: BOBCAPS Research

FIG 4 – SOTP VALUATION SUMMARY

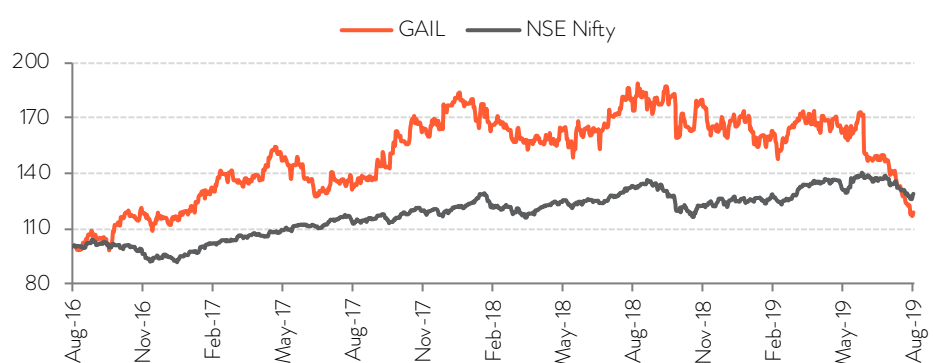
Details	Value (Rs bn)	Value (Rs/sh)	Description
Natural gas and LPG transmission	242	54	DCF
Gas trading	167	37	5x Sep'21 EBITDA
LPG & LHC production	142	31	6x Sep'21E EBITDA
Petrochemicals production	66	15	6x Sep'21E EBITDA
Value of investment in listed companies	616	137	20% discount to CMP
Other business valuations	98	22	At book value of investments (OPAL, BCPL, Gail Gas, etc.)
Total EV	834	185	7.4x FY21E EBITDA
Less: Net debt	41	9	
Equity Value	792	175	Implies ~12x EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY20E	FY21E	FY22E
Gas transmission volumes (mmscmd)	115	135	145
Transmission tariffs (Rs/scm)	1.5	1.5	1.5
Gas trading volumes (mmscmd)	105	110	115
Gas trading margins (Rs/scm)	1.6	1.6	1.6
PE sales volumes (000 tpa)	560	720	720
Benchmark PE price (US\$/mt)	950	1,000	1,050
LPG/LHC sales volumes (000 tpa)	1,461	1,453	1,453
LPG/LHC realisation (US\$/mt)	450	500	550

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

Key risks to our estimates are:

- lower-than-expected growth in gas transmission and trading volumes,
- negative margins from higher pricing of US LNG contracts, and
- a sharp decline in oil prices (to <US\$ 50/bbl) which could impact LPG and petrochemical business earnings.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Total revenue	574,866	802,795	626,416	724,423	794,785
EBITDA	76,339	95,556	104,847	120,553	129,109
EBIT	62,188	80,054	88,314	102,509	109,574
Net interest income/(expenses)	(2,751)	(1,385)	(2,506)	(4,175)	(6,001)
Other income/(expenses)	9,870	15,448	8,762	5,747	6,662
Exceptional items	277	0	0	0	0
EBT	69,307	94,116	94,570	104,081	110,235
Income taxes	(23,400)	(30,591)	(33,572)	(36,949)	(39,133)
Reported net profit	46,184	63,525	60,998	67,132	71,102
Adjusted net profit	46,000	63,525	60,998	67,132	71,102

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Accounts payables	38,816	39,612	38,001	43,985	48,848
Other current liabilities	68,372	72,060	68,372	68,372	68,372
Provisions	14,283	14,253	14,283	14,283	14,283
Debt funds	9,761	8,706	33,501	50,006	70,006
Other liabilities	46,309	44,676	66,860	66,860	66,860
Equity capital	22,551	22,551	45,101	45,101	45,101
Reserves & surplus	380,731	412,787	416,692	452,408	490,235
Shareholders' fund	403,281	435,338	461,793	497,509	535,337
Total liabilities and equities	580,822	614,645	682,810	741,015	803,705
Cash and cash eq.	25,294	12,147	20,081	20,736	29,228
Accounts receivables	40,515	40,602	42,770	47,667	51,380
Inventories	19,195	23,219	20,047	23,100	25,352
Other current assets	53,249	40,509	58,187	60,831	63,600
Investments	99,531	95,282	109,531	114,531	119,531
Net fixed assets	289,299	310,861	373,164	414,636	454,859
CWIP	53,739	92,025	59,030	59,515	59,758
Total assets	580,822	614,644	682,810	741,015	803,706

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net income + Depreciation	63,621	79,027	77,530	85,176	90,637
Changes in working capital	26,994	13,085	(21,944)	(4,609)	(3,870)
Other operating cash flows	(1,066)	(17,081)	13,422	(5,747)	(6,662)
Cash flow from operations	89,548	75,030	69,008	74,819	80,104
Capital expenditures	(37,379)	(75,350)	(45,842)	(60,000)	(60,000)
Change in investments	(5,760)	4,249	(14,249)	(5,000)	(5,000)
Other investing cash flows	9,870	15,448	8,762	5,747	6,662
Cash flow from investing	(33,268)	(55,653)	(51,329)	(59,253)	(58,338)
Equities issued/Others	5,638	0	22,551	0	0
Debt raised/repaid	(20,284)	(1,055)	24,795	16,505	20,000
Interest expenses	(2,751)	(1,385)	(2,506)	(4,175)	(6,001)
Dividends paid	(18,936)	(24,668)	(57,092)	(31,417)	(33,274)
Other financing cash flows	(8,070)	(5,416)	2,506	4,175	6,001
Cash flow from financing	(44,404)	(32,525)	(9,746)	(14,911)	(13,274)
Changes in cash and cash eq.	11,875	(13,147)	7,934	655	8,492
Closing cash and cash eq.	25,294	12,147	20,081	20,736	29,228

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
Reported EPS	20.5	28.2	13.5	14.9	15.8
Adjusted EPS	10.2	14.1	13.5	14.9	15.8
Dividend per share	7.2	9.4	10.8	6.0	6.3
Book value per share	178.8	193.0	102.4	110.3	118.7

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
EV/Sales	9.7	6.9	8.9	7.7	7.1
EV/EBITDA	73.4	58.3	53.2	46.4	43.5
Adjusted P/E	12.1	8.8	9.2	8.3	7.9
P/BV	0.7	0.6	1.2	1.1	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	66.1	67.5	64.5	64.5	64.5
Interest burden (PBT/EBIT)	111.9	117.6	107.1	101.5	100.6
EBIT margin (EBIT/Revenue)	10.8	10.0	14.1	14.2	13.8
Asset turnover (Revenue/Avg TA)	101.4	134.3	96.6	101.8	102.9
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.5	1.5
Adjusted ROAE	11.7	15.1	13.6	14.0	13.8

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	11.8	39.6	(22.0)	15.6	9.7
EBITDA	19.1	25.2	9.7	15.0	7.1
Adjusted EPS	43.1	38.1	(4.0)	10.1	5.9
Profitability & Return ratios (%)					
EBITDA margin	13.3	11.9	16.7	16.6	16.2
EBIT margin	10.8	10.0	14.1	14.2	13.8
Adjusted profit margin	8.0	7.9	9.7	9.3	8.9
Adjusted ROAE	11.7	15.1	13.6	14.0	13.8
ROCE	10.0	12.6	12.1	12.7	12.3
Working capital days (days)					
Receivables	25	18	24	23	23
Inventory	15	12	17	15	15
Payables	24	20	27	25	25
Ratios (x)					
Gross asset turnover	1.3	1.7	1.2	1.2	1.2
Current ratio	1.1	0.9	1.2	1.2	1.3
Net interest coverage ratio	22.6	57.8	35.2	24.6	18.3
Adjusted debt/equity	0.0	0.0	0.0	0.1	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

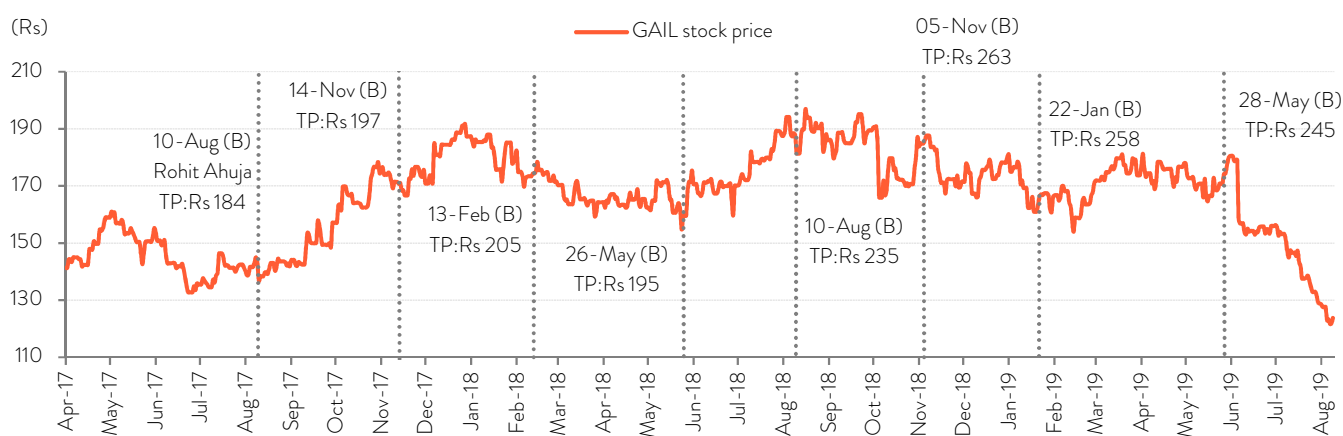
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: GAIL (GAIL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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