

BUY

TP: Rs 155 | ▲ 72%

GAIL

Oil & Gas

10 November 2020

Operating parameters return to normalcy

GAIL's Q2FY21 PAT was in line at Rs 12.4bn (+17% YoY), driven by an improved operating performance across segments (except trading). Q2 highlights: (a) gas trading continued to report losses (Rs 3.4bn), stung by weakness in US LNG contracts; (b) gas transmission/petrochemical earnings outperformed at Rs 12.8bn (+26% YoY)/Rs 2.9bn (9x YoY) on higher volumes and margins. Operations have recovered to pre-Covid levels, reinforcing our investment argument of a speedy return to normalcy. We maintain our Sep'21 TP at Rs 155.

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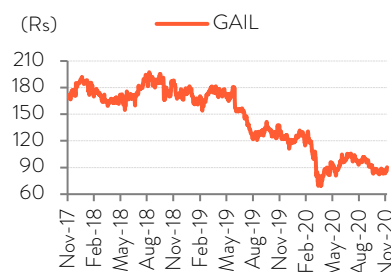
V-shaped recovery in volumes: Gas transmission volumes at 106.4mmscmd (+18% QoQ) were above our estimates. The outlook on GAIL's volumes remains buoyant, supported by (a) low spot LNG prices that could accelerate demand recovery (visible from a surge in offtake from the power sector), (b) commissioning of new pipelines (Kochi-Mangaluru and Jagdishpur-Haldia by end-FY22) which carry ~15mmscmd volume potential, and (c) ample gas supply options emerging across India from incremental LNG regasification capacities (~50mmscmd) and domestic gas production (ONGC/RIL: 20-30mmscmd) over 3-5 years that could help create incremental demand.

Ticker/Price	GAIL IN/Rs 90
Market cap	US\$ 5.5bn
Shares o/s	4,510mn
3M ADV	US\$ 16.4mn
52wk high/low	Rs 133/Rs 65
Promoter/FPI/DII	52%/15%/33%

Source: NSE

Petchem turns around; trading margins remain negative: Petchem returned to profitability in Q2 owing to better margins from low LNG prices and >90% utilisation of crackers. On the other hand, gas trading sustained losses on low spot LNG prices. LPG/LHC segment earnings were in line at Rs 3bn (+11% YoY). The recent rise in oil prices could bolster these segment's earnings in H2.

STOCK PERFORMANCE



Source: NSE

Reiterate BUY: At 6.9x FY22E EPS, risk-reward remains attractive (akin to other PSUs). Our SOTP target price of Rs 155 builds in worst-case assumptions across segments, especially gas trading and petrochemicals (which form just ~10% of our valuation for GAIL).

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	802,836	718,710	392,246	521,799	596,284
EBITDA (Rs mn)	95,556	84,710	77,833	92,687	106,713
Adj. net profit (Rs mn)	63,525	49,658	48,430	59,678	67,698
Adj. EPS (Rs)	14.1	11.0	10.7	13.2	15.0
Adj. EPS growth (%)	38.1	(21.8)	(2.5)	23.2	13.4
Adj. ROAE (%)	15.0	11.3	10.8	12.6	13.3
Adj. P/E (x)	6.4	8.2	8.4	6.8	6.0
EV/EBITDA (x)	4.3	4.7	5.6	4.8	4.0

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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



FIG 1 – QUARTERLY PERFORMANCE (STANDALONE)

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net sales	136,427	180,399	(24.4)	120,875	12.9	257,296	363,505	(29.2)
Purchase of traded goods	95,369	136,220	(30.0)	88,318	8.0	183,687	268,696	(31.6)
% of sales	69.9	75.5	-	73.1	-	71.4	73.9	-
Other expenditure	27,677	28,552	(3.1)	26,324	5.1	54,002	56,593	(4.6)
% of sales	20.3	15.8	-	21.8	-	21.0	15.6	-
EBITDA	13,381	15,627	(14.4)	6,232	114.7	19,608	38,217	(48.7)
EBITDA margin (%)	9.8	8.7	-	5.2	-	7.6	10.5	-
Depreciation and amortisation	4,843	4,398	10.1	4,583	5.7	9,426	8,455	11.5
EBIT	8,538	11,229	(24.0)	1,649	417.8	10,182	29,762	(65.8)
Interest	274	275	(0.3)	495	(44.6)	769	514	49.6
Other income	7,239	4,401	64.5	2,413	200.0	9,653	5,913	63.3
PBT	15,503	15,355	1.0	3,568	334.6	19,065	35,160	(45.8)
Provision for tax	3,107	4,713	(34.1)	1,007	208.6	4,114	11,643	(64.7)
PAT (adjusted)	12,397	10,643	16.5	2,561	384.1	14,952	23,518	(36.4)
NPM (adj.) (%)	9.1	5.9	-	2.1	-	5.8	6.5	-
Adjusted EPS (Rs)	2.7	2.4	16.5	0.6	384.1	3.3	5.2	(36.4)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT-WISE PERFORMANCE

Y/E March (Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Natural Gas transmission								
Revenue	15,400	14,150	8.8	12,681	21.4	28,081	58,459	(52.0)
Volume (mmscmd)	106.44	108.70	(2.1)	90.22	18.0	98.33	108.04	(9.0)
Realisation (Rs/scm)	1.57	1.41	11.1	1.54	1.8	1.56	1.48	5.6
EBITDA	12,810	10,200	25.6	9,530	34.4	22,340	20,880	7.0
PBIT	10,212	8,028	27.2	7,167	42.5	17,378	16,622	4.5
LPG transmission								
Revenue	1,695	1,612	5.1	1,536	10.4	3,230	6,032	(46.4)
Volume ('000 MT)	1,058	999	5.9	963	9.9	2,021	1,826	10.7
Realisation (Rs/MT)	1,602	1,613	(0.7)	1,594	0.5	1,598	1,656	(3.5)
EBITDA	1,030	960	7.3	960	7.3	1,990	1,720	15.7
PBIT	882	814	8.4	815	8.3	1,697	1,429	18.7
Natural Gas Trading								
Revenue (Rs mn)	105,067	150,858	(30.4)	94,437	11.3	199,504	632,423	(68.5)
Volume (mmscmd)	88.60	94.70	(6.4)	81.16	9.2	84.88	95.75	(11.4)
Realisation (Rs/scm)	12.89	17.32	(25.6)	12.79	0.8	12.84	16.97	(24.4)
EBITDA	(3,350)	2,540	(231.9)	(5,170)	(35.2)	(8,520)	11,150	(176.4)
PBIT (Rs mn)	(3,640)	2,366	(253.8)	(5,455)	(33.3)	(9,094)	10,871	(183.7)
Petrochemicals								
Revenue (Rs mn)	16,847	16,192	4.0	12,217	37.9	29,064	52,724	(44.9)
Volume ('000 MT)	221	228	(3.1)	183	20.8	404	364	11.0
Realisation (Rs/MT)	76,232	71,016	7.3	66,759	14.2	71,495	79,964	(10.6)
Realisation (US\$/MT)	1,025	960	6.8	878	16.6	951	1,129	(15.8)
EBITDA	2,890	320	803.1	(430)	(772.1)	2,460	(850)	(389.4)
PBIT (Rs mn)	1,763	(823)	314.2	(1,544)	214.2	219	(1,321)	116.6

Y/E March (Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
LPG and Liquid HC								
Revenue (Rs mn)	8,030	9,605	(16.4)	7,479	7.4	15,510	42,854	(63.8)
Volume ('000 MT)	293	329	(10.9)	265	10.6	558	625	(10.7)
Realisation (US\$/MT)	368	395	(6.6)	371	(0.8)	370	467	(20.8)
EBITDA	3,020	2,730	10.6	2,860	5.6	5,880	8,190	(28.2)
PBIT (Rs mn)	2,802	2,454	14.2	2,662	5.2	5,464	7,561	(28)
Others								
Revenue (Rs mn)	2,267	2,890	(21.6)	2,461	(7.9)	4,728	8,357	(43.4)
EBITDA	4,220	3,260	29.4	890	(374.2)	5,110	3,260	56.7
PBIT (Rs mn)	913	1,767	(48.3)	1,169	(21.9)	2,082	3,278	(36.5)
Total	149,306	195,307	(23.6)	130,811	14.1	280,117	800,848	(65.0)

Source: Company, BOBCAPS Research

Earnings call highlights

- Capacity utilisation in the gas transmission segment increased to 52% in Q2FY21 vs. 44% in Q1, in polymer production (petchem) to 108% vs. 66%, in LPG/LHC to 81% vs. 76%, and in LPG transmission to 111% vs. 101%. Higher utilisation is evidence that the lockdown impact has been neutralised. Petrochemical and LPG/LHC plants are operating at optimal capacity.
- Out of 86 US LNG cargoes scheduled for the year, GAIL has purchased 41 (of these, 15 have been sold overseas and the remaining 26 were brought to India). In Q2, GAIL received 20 US LNG cargoes (21 in Q1), of which 6 were sold in the overseas market and the remaining were brought to India.
- Earnings increased in the transmission segment due to higher transmission volumes and an increase in other income (on reversal of a Rs 0.96bn provision on resumption of work in the Tamil Nadu section of the KKB MPL project).
- Losses in natural gas trading have narrowed QoQ due to better realisations on sale of US LNG cargoes in the overseas market and reduction in inventory valuation losses. But prevailing low crude prices and a subdued spot LNG market led to losses in the imported LNG portfolio for the domestic market.
- GAIL Gas' turnover was at Rs 9.4bn in H1 (vs. Rs 7bn in H1FY20). The CGD sector has staged a speedy recovery after staggered relaxation of the lockdown.
- Q2 capex was at Rs 15bn (Rs 4bn in Q1) which includes pipeline, equity contribution, operations capex and E&P. GAIL plans to achieve Rs 65bn of capex for FY21 and Rs 66bn for FY22.
- The Kochi-Mangaluru pipeline had been delayed due to technical difficulties but is expected to be completed by this month, post which Mangalore Chemicals & Fertilizers (MCF) will offtake ~0.7mmscmd gas to start with.
- Supply to Ramagundam Fertilizers' plant has started. Gas offtake should cross 1.5mmscmd by December-end.

Valuation methodology

At 6.9x FY22E EPS, risk-reward remains attractive (akin to other PSUs). Our Sep'21 SOTP target price remains unchanged at Rs 155 and builds in worst-case assumptions across segments, especially gas trading and petrochemicals (which form just ~10% of our valuation for GAIL). Reiterate BUY.

FIG 3 – SOTP VALUATION SUMMARY

Details	Value (Rs bn)	Value (Rs/sh)	Description
Natural gas and LPG transmission	274	61	DCF and 15x Sep'22E EBITDA respectively
Gas trading	45	10	5x Sep'22E EBITDA
LPG & LHC production	141	31	6x Sep'22E EBITDA
Petrochemicals production	36	8	6x Sep'22E EBITDA
Value of investment in listed companies	125	27	20% discount to CMP
Other business valuations	88	20	At book value of investments (OPAL, BCPL, Gail Gas, etc.)
Total EV	720	159	9x FY22E EBITDA
Less: Net debt	15.7	3	-
Equity Value	704	155	Implies ~11.7x FY22E EPS

Source: BOBCAPS Research

FIG 4 – KEY ASSUMPTIONS

	FY21E	FY22E	FY23E
Gas transmission volumes (mmscmd)	115	125	140
Transmission tariffs (Rs/scm)	1.50	1.50	1.50
Gas trading volumes (mmscmd)	90	110	110
Gas trading margins on LNG (Rs/scm)	-	0.3	0.6
PE sales volumes (000 tpa)	695	720	733
Gross PE realisation (US\$/MT)	1,003	1,062	1,121
LPG/LHC sales volumes (000 tpa)	1,453	1,453	1,453
Gross LPG/LHC realisation (US\$/MT)	350	375	400

Source: BOBCAPS Research

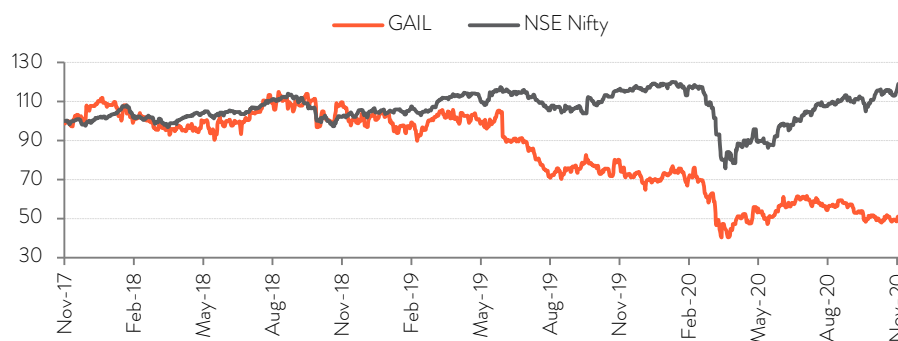
FIG 5 – SEGMENT EBITDA OUTLOOK

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Gas transmission	38,884	44,720	50,370	54,750	60,860
% total segment EBITDA	48.1	56.2	64.7	59.1	57.0
% YoY growth	7.0	15.0	12.6	8.7	11.2
Gas trading	23,694	22,700	1,981	6,711	11,471
% total segment EBITDA	29.3	28.5	2.5	7.2	10.7
% YoY growth	88.8	(4.2)	(91.3)	238.7	70.9
Petrochemicals	8,150	2,050	2,330	5,640	6,254
% total segment EBITDA	10.1	2.6	3.0	6.1	5.9
% YoY growth	18.3	(74.8)	13.7	142.0	10.9
LPG & Liquid HC	6,364	6,241	19,955	22,390	24,931
% total segment EBITDA	7.9	7.8	25.6	24.2	23.4

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
% YoY growth	(73.2)	(1.9)	219.7	12.2	11.3
LPG transmission	3,669	3,900	3,196	3,196	3,196
% total segment EBITDA	4.5	4.9	4.1	3.4	3.0
% YoY growth	12.5	6.3	(18.0)	0.0	0.0
Total EBITDA	95,556	84,710	77,833	92,687	106,713

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- below-expected growth in gas transmission and trading volumes,
- negative margins from higher pricing of US LNG contracts, and
- further decline in oil prices (to <US\$ 30/bbl) which could impact LPG and petrochemical business earnings.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	802,836	718,710	392,246	521,799	596,284
EBITDA	95,556	84,710	77,833	92,687	106,713
Depreciation	(15,502)	(18,360)	(18,043)	(19,535)	(21,003)
EBIT	80,054	66,350	59,790	73,152	85,710
Net interest income/(expenses)	(1,385)	(1,085)	(5,175)	(5,001)	(6,001)
Other income/(expenses)	15,448	14,168	10,132	11,632	10,796
EBT	94,116	79,434	64,746	79,783	90,506
Income taxes	(30,591)	(13,227)	(16,316)	(20,105)	(22,807)
Reported net profit	63,525	66,206	48,430	59,678	67,698
Adjustments	0	(16,548)	0	0	0
Adjusted net profit	63,525	49,658	48,430	59,678	67,698

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	39,612	41,284	28,172	30,560	35,271
Other current liabilities	72,060	81,267	81,267	81,267	81,267
Provisions	14,253	12,847	14,283	14,283	14,283
Debt funds	16,157	63,151	50,006	50,006	70,006
Other liabilities	44,676	38,367	58,531	63,808	69,515
Equity capital	22,551	45,101	45,101	45,101	45,101
Reserves & surplus	418,378	394,610	410,803	443,626	480,860
Shareholders' fund	440,929	439,711	455,904	488,727	525,961
Total liabilities and equities	627,687	676,626	688,163	728,651	796,302
Cash and cash eq.	12,147	8,039	34,293	15,539	30,115
Accounts receivables	50,743	55,759	30,262	37,116	40,953
Inventories	23,219	29,601	12,573	16,728	19,070
Other current assets	39,314	57,635	60,831	63,600	66,498
Investments	96,240	74,985	79,985	84,985	89,985
Net fixed assets	310,861	336,450	412,809	453,031	491,908
CWIP	92,025	105,819	59,515	59,758	59,879
Total assets	624,548	668,288	690,268	730,756	798,407

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	79,027	84,566	66,473	79,213	88,701
Changes in working capital	4,138	(20,246)	27,653	(11,389)	(4,367)
Other operating cash flows	(17,081)	(20,478)	10,033	(6,354)	(5,090)
Cash flow from operations	66,084	43,842	104,159	61,470	79,244
Capital expenditures	(75,350)	(57,743)	(48,099)	(60,000)	(60,000)
Change in investments	3,291	21,255	(5,000)	(5,000)	(5,000)
Other investing cash flows	15,448	14,168	10,132	11,632	10,796
Cash flow from investing	(56,611)	(22,320)	(42,967)	(53,368)	(54,204)
Equities issued/Others	0	(1,218)	0	0	0
Debt raised/repaid	6,396	46,993	(13,145)	0	20,000
Interest expenses	(1,385)	(1,085)	(5,175)	(5,001)	(6,001)
Dividends paid	(24,668)	(29,131)	(21,794)	(26,855)	(30,464)
Other financing cash flows	(5,416)	(40,842)	5,175	5,001	6,001
Cash flow from financing	(25,073)	(25,282)	(34,938)	(26,855)	(10,464)
Changes in cash and cash eq.	(15,600)	(3,760)	26,254	(18,754)	14,576
Closing cash and cash eq.	9,694	8,387	34,293	15,539	30,115

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	28.2	14.7	10.7	13.2	15.0
Adjusted EPS	14.1	11.0	10.7	13.2	15.0
Dividend per share	9.4	6.5	4.8	6.0	6.8
Book value per share	195.5	97.5	101.1	108.4	116.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.5	0.6	1.1	0.8	0.7
EV/EBITDA	4.3	4.7	5.6	4.8	4.0
Adjusted P/E	6.4	8.2	8.4	6.8	6.0
P/BV	0.5	0.9	0.9	0.8	0.8

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	67.5	62.5	74.8	74.8	74.8
Interest burden (PBT/EBIT)	117.6	119.7	108.3	109.1	105.6
EBIT margin (EBIT/Revenue)	10.0	9.2	15.2	14.0	14.4
Asset turnover (Revenue/Avg TA)	133.2	111.2	57.7	73.4	78.0
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	15.0	11.3	10.8	12.6	13.3

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	39.7	(10.5)	(45.4)	33.0	14.3
EBITDA	25.2	(11.4)	(8.1)	19.1	15.1
Adjusted EPS	38.1	(21.8)	(2.5)	23.2	13.4
Profitability & Return ratios (%)					
EBITDA margin	11.9	11.8	19.8	17.8	17.9
EBIT margin	10.0	9.2	15.2	14.0	14.4
Adjusted profit margin	7.9	6.9	12.3	11.4	11.4
Adjusted ROAE	15.0	11.3	10.8	12.6	13.3
ROCE	12.4	11.5	8.9	10.5	11.3
Working capital days (days)					
Receivables	21	27	40	24	24
Inventory	12	17	30	14	15
Payables	20	23	40	25	25
Ratios (x)					
Gross asset turnover	1.7	1.4	0.7	0.8	0.8
Current ratio	0.9	0.9	1.1	1.1	1.2
Net interest coverage ratio	57.8	61.2	11.6	14.6	14.3
Adjusted debt/equity	0.0	0.1	0.0	0.1	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

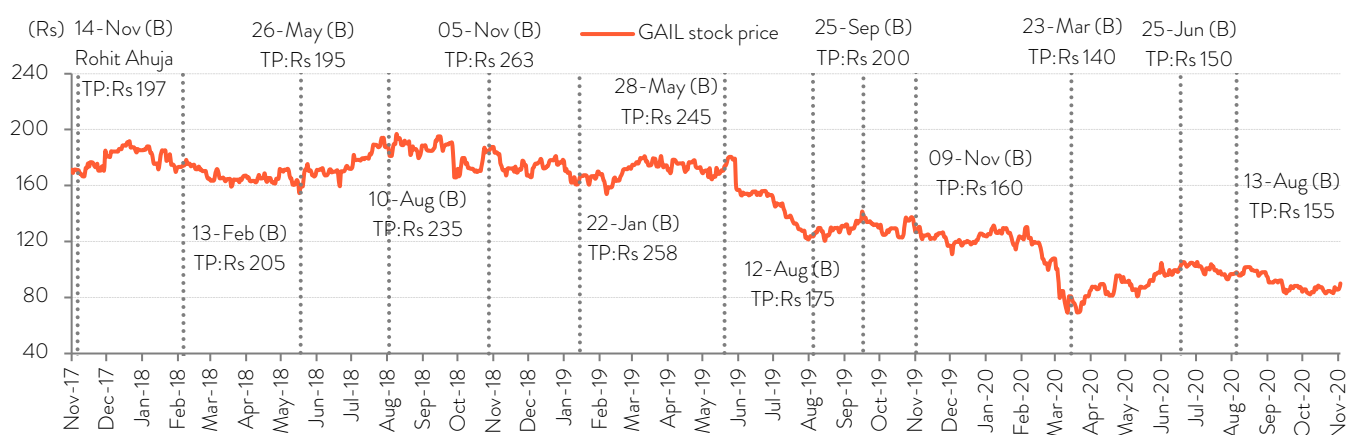
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): GAIL (GAIL IN)



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

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