

BUY

TP: Rs 160 | ▲ 31%

GAIL

Oil & Gas

10 February 2020

Operationally robust; demerger uncertainty priced in

GAIL's Q3FY20 PAT was in line at Rs 10.2bn (-40% YoY). While gross margins outperformed across segments, earnings were muted due to high taxes. Key Q3 highlights: (a) gas trading EBITDA recovered to Rs 5.2bn (2x QoQ) on normalised margins, (b) gas transmission EBITDA outperformed at Rs 12.2bn (+14% YoY) despite lower volumes at 110mmscmd, and (c) LPG/petchem EBITDA beat estimates backed by better margins/volumes. Our TP remains unchanged at Rs 160 (rolled over to Mar'21).

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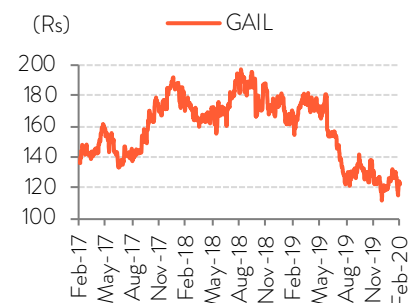
Gas transmission volumes underperform: While Q3 gas transmission volumes were lower than expected at ~110mmscmd (+2.4% YoY), tariffs beat estimates at Rs 1.56/scm (+5.2% YoY), leading to outperformance on EBITDA. Commissioning of the Kochi-Mangalore (Q1FY21) and Jagdishpur-Haldia pipelines (by end-FY22) could add ~15mmscmd to volumes from FY22. With the issue of tariffs now being settled for good, GAIL's pipeline business potential looks increasingly buoyant given new LNG regasification and expected improvement in domestic gas production (from RIL and ONGC).

Ticker/Price	GAIL IN/Rs 122
Market cap	US\$ 7.7bn
Shares o/s	4,510mn
3M ADV	US\$ 18.9mn
52wk high/low	Rs 183/Rs 110
Promoter/FPI/DII	53%/19%/29%

Source: NSE

Gas trading recovers: Q3 gas trading EBITDA recovered to Rs 5.2bn (-22% YoY, 2x QoQ), helped by low spot LNG prices. Prices for long-term contracts (at US\$ 6-7/mmbtu) remain disconnected from spot LNG prices (<US\$ 3/mmbtu currently), putting pressure on volume expansion prospects (trading volumes remained flat YoY at 96mmscmd).

STOCK PERFORMANCE



Reiterate BUY: At 9x FY22E 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 SOTP target price of Rs 160 builds in worst-case assumptions across segments.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	574,866	802,795	546,413	654,786	716,354
EBITDA (Rs mn)	76,339	95,556	74,011	90,053	94,617
Adj. net profit (Rs mn)	46,000	63,525	54,448	61,957	61,473
Adj. EPS (Rs)	10.2	14.1	12.1	13.7	13.6
Adj. EPS growth (%)	43.1	38.1	(14.3)	13.8	(0.8)
Adj. ROAE (%)	11.7	15.1	11.8	12.4	11.6
Adj. P/E (x)	11.9	8.6	10.1	8.9	8.9
EV/EBITDA (x)	7.6	5.8	7.3	6.1	6.0

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE (STANDALONE)

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Net sales	178,827	197,890	(9.6)	180,399	(0.9)	542,333	563,629	(3.8)
Purchase of traded goods	133,949	144,190	(7.1)	136,220	(1.7)	402,645	410,589	(1.9)
% of sales	74.9	72.9	-	75.5	-	74.2	72.8	-
Other expenditure	23,165	26,965	(14.1)	28,552	(18.9)	79,758	74,330	7.3
% of sales	13.0	13.6	-	15.8	-	14.7	13.2	-
EBITDA	21,713	26,735	(18.8)	15,627	38.9	59,930	78,710	(23.9)
EBITDA margin (%)	12.1	13.5	-	8.7	-	11.1	14.0	-
Depreciation and amortisation	5,349	3,634	47.2	4,398	21.6	13,803	10,929	26.3
EBIT	16,365	23,101	(29.2)	11,229	45.7	46,127	67,782	(31.9)
Interest	306	227	35.0	275	11.2	820	1,122	(26.9)
Other income	1,960	2,201	(10.9)	4,401	(55.5)	7,872	6,789	16.0
PBT	18,019	25,075	(28.1)	15,355	17.3	53,179	73,449	(27.6)
Provision for tax	7,868	8,262	(4.8)	4,713	67.0	19,511	24,415	(20.1)
PAT (adjusted)	10,151	16,812	(39.6)	10,643	(4.6)	33,669	49,034	(31.3)
NPM (adj.) (%)	5.7	8.5	-	5.9	-	6.2	8.7	-
Adjusted EPS (Rs)	2.3	3.7	(39.6)	2.4	(4.6)	7.5	10.9	(31.3)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT-WISE PERFORMANCE

Y/E March (Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Natural Gas Transmission								
Revenue	15,855	14,722	7.7	14,150	12.1	74,314	43,145	72.2
Volume (mmscmd)	110.30	107.70	2.4	108.70	1.5	109.17	106.88	2.1
Realisation (Rs/scm)	1.56	1.49	5.2	1.41	10.4	1.52	1.45	4.8
EBITDA	12,200	10,720	13.8	10,200	19.6	33,080	30,610	8.1
PBIT	9,855	8,837	11.5	8,028	22.8	26,477	24,810	6.7
LPG Transmission								
Revenue	1,688	1,540	9.6	1,612	4.7	7,719	4,473	72.6
Volume ('000 MT)	1,043	1,036	0.7	999	4.4	2,869	2,952	(2.8)
Realisation (Rs/MT)	1,618	1,486	8.9	1,613	0.3	1,637	1,515	8.0
EBITDA	1,080	910	18.7	960	12.5	2,800	2,500	12.0
PBIT	935	767	21.9	814	14.9	2,364	2,073	14.0
Natural Gas Trading								
Revenue	171,576	161,969	5.9	150,858	13.7	803,999	458,835	75.2
Volume (mmscmd)	96.00	96.00	-	94.70	1.4	95.88	96.45	(0.6)
Realisation (Rs/scm)	19.43	18.34	5.9	17.32	12.2	18.20	17.30	5.2
EBITDA	5,240	6,750	(22.4)	2,540	106.3	16,390	22,710	(27.8)
PBIT	4,526	6,754	(33.0)	2,366	91.3	15,397	22,715	(32.2)
Petrochemicals								
Revenue	14,828	15,994	(7.3)	16,192	(8.4)	67,552	49,850	35.5
Volume ('000 MT)	211	173	22.0	228	(7.5)	575	534	7.7
Realisation (Rs/MT)	70,276	92,451	(24.0)	71,016	(1.0)	75,120	93,940	(20.0)
Realisation (US\$/MT)	983	1,227	(19.9)	960	2.4	1,056	1,295	(18.4)
EBITDA	1,050	1,380	(23.9)	320	228.1	200	7,260	(97.2)
PBIT (US\$/MT)	(6)	23	(124.9)	(49)	(88.4)	-	104	(100.0)

Y/E March (Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
LPG and Liquid HC								
Revenue	9,736	15,122	(35.6)	9,605	1.4	52,590	39,613	32.8
Volume ('000 MT)	337	342	(1.5)	329	2.4	962	994	(3.2)
Realisation (US\$/MT)	404	587	(31.1)	395	2.4	435	549	(20.7)
EBITDA	3,692	8,490	(56.5)	2,730	35.2	11,370	21,780	(47.8)
PBIT	1,733	8,332	(79.2)	2,454	(29.4)	10,525	21,304	(51)
Others								
Revenue	2,000	1,861	7.5	2,890	(30.8)	8,376	2,000	318.8
EBITDA	3,260	690	372.5	3,260	-	4,360	(350)	(1,345.7)
PBIT	1,510	773	95.5	1,767	(14.5)	4,616	2,080	121.9
Total Revenues	218,954	211,206	3.7	195,307	12.1	1,014,551	597,915	69.7

Source: Company, BOBCAPS Research

Earnings call highlights

- GAIL incurred capex of Rs 38bn over 9MFY20 largely towards pipeline infrastructure.
- GAIL Gas achieved a turnover of Rs 26bn and PAT of Rs 1.1bn in Q3. This is expected to improve on ramp-up of CGD volumes. Capex of Rs 30bn has been spent on Gail Gas until now.
- The Kochi-Mangalore pipeline is in the advanced stages of completion and should be fully commissioned by Mar-Apr'20. Capex of Rs 40bn has been incurred on this pipeline until now.
- Urja-Ganga pipeline tariffs are at Rs 63/mmbtu. The pipeline could have a potential of 8-9mmscmd by FY21-FY22, though volumes are expected to ramp up slowly depending on the commissioning of fertiliser plants.
- Out of the 14.5mt of LNG sourcing contracts, 2.5mt was sold outside India and 0.5mt went unsold. However, once the fertiliser plants (Gorakhpur, Sindri, Ramagundam, Barauni and Matix) are commissioned and connectivity established, all the LNG will be sold in India.

Valuation methodology

At 9x FY22E 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. We marginally adjust estimates post the Q3FY20 results – on rollover, we have an unchanged Mar'21 SOTP-based target price of Rs 160 which builds in worst-case assumptions across segments. Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	605,598	546,413	(9.8)	701,945	654,786	(6.7)	769,571.7	716,354	(6.9)
EBITDA	80,708	74,011	(8.3)	96,982	90,053	(7.1)	102,802.1	94,617	(8.0)
EBITDA margin (%)	13.3	13.5	-	13.8	13.8	-	13.4	13.2	-
PAT	56,278	54,448	(3.3)	62,048	61,957	(0.1)	61,809.5	61,473	(0.5)
PAT margin (%)	9.3	10.0	-	8.8	9.5	-	8.0	8.6	-
EPS (Rs)	12.5	12.1	(3.3)	13.8	13.7	(0.1)	13.7	13.6	(0.5)

Source: BOBCAPS Research

FIG 4 – SOTP VALUATION SUMMARY

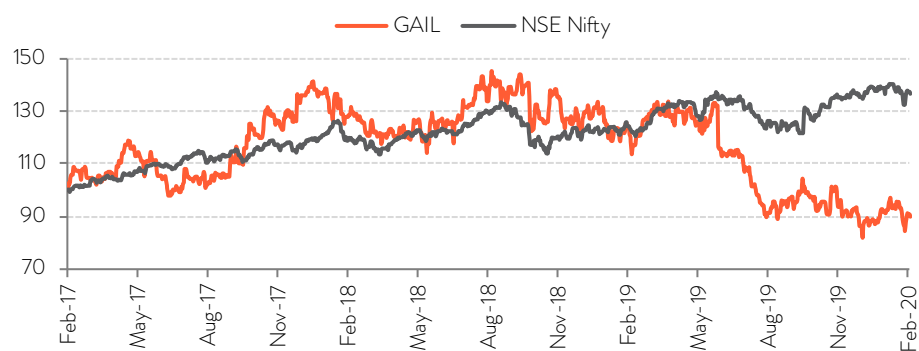
Details	Value (Rs bn)	Value (Rs/sh)	Description
Natural gas and LPG transmission	233	52	DCF
Gas trading	106	24	5x FY22E EBITDA
LPG & LHC production	112	25	6x FY22E EBITDA
Petrochemicals production	19	4	6x FY22E EBITDA
Value of investment in listed companies	154	34	20% discount to CMP
Other business valuations	22	22	At book value of investments (OPAL, BCPL, Gail Gas, etc.)
Total EV	725	161	8.4x FY21E EBITDA
Less: Net debt	7.6	2	-
Equity Value	717	160	Implies ~11.7x FY22E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

	FY20E	FY21E	FY22E
Gas transmission volumes (mmscmd)	110	125	135
Transmission tariffs (Rs/scm)	1.5	1.5	1.5
Gas trading volumes (mmscmd)	96	105	110
Gas trading margins (Rs/scm)	1.6	1.6	1.6
PE sales volumes (000 tpa)	560	720	720
Benchmark PE price (US\$/mt)	850	950	950
LPG/LHC sales volumes (000 tpa)	1,461	1,453	1,453
LPG/LHC realisation (US\$/mt)	420	450	475

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

Key downside 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	FY19A	FY20E	FY21E	FY22E
Total revenue	574,866	802,795	546,413	654,786	716,354
EBITDA	76,339	95,556	74,011	90,053	94,617
Depreciation	(14,151)	(15,502)	(16,533)	(18,043)	(19,535)
EBIT	62,188	80,054	57,479	72,010	75,082
Net interest income/(expenses)	(2,751)	(1,385)	(3,506)	(5,425)	(6,751)
Other income/(expenses)	9,870	15,448	18,819	16,245	13,852
Exceptional items	277	0	0	0	0
EBT	69,307	94,116	72,791	82,830	82,183
Income taxes	(23,400)	(30,591)	(18,343)	(20,873)	(20,710)
Reported net profit	46,184	63,525	54,448	61,957	61,473
Adjusted net profit	46,000	63,525	54,448	61,957	61,473

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	38,816	39,612	33,725	40,840	45,434
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	53,501	55,006	80,006
Other liabilities	46,309	44,676	46,639	46,639	46,639
Equity capital	22,551	22,551	45,101	45,101	45,101
Reserves & surplus	380,731	412,787	440,010	470,988	501,725
Shareholders' fund	403,281	435,338	485,111	516,089	546,826
Total liabilities and equities	580,822	614,645	701,631	741,229	801,559
Cash and cash eq.	25,294	12,147	45,890	27,006	33,924
Accounts receivables	40,515	40,602	38,427	43,904	47,138
Inventories	19,195	23,219	17,402	20,807	22,750
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	701,632	741,230	801,560

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	63,621	79,027	70,981	80,000	81,008
Changes in working capital	26,994	13,085	(19,231)	(4,411)	(3,353)
Other operating cash flows	(1,066)	(17,081)	(16,855)	(16,245)	(13,852)
Cash flow from operations	89,548	75,030	34,894	59,344	63,803
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	18,819	16,245	13,852
Cash flow from investing	(33,268)	(55,653)	(41,272)	(48,755)	(51,148)
Equities issued/Others	5,638	0	22,551	0	0
Debt raised/repaid	(20,284)	(1,055)	44,795	1,505	25,000
Interest expenses	(2,751)	(1,385)	(3,506)	(5,425)	(6,751)
Dividends paid	(18,936)	(24,668)	(27,224)	(30,978)	(30,736)
Other financing cash flows	(8,070)	(5,416)	3,506	5,425	6,751
Cash flow from financing	(44,404)	(32,525)	40,121	(29,473)	(5,736)
Changes in cash and cash eq.	11,875	(13,147)	33,743	(18,884)	6,918
Closing cash and cash eq.	25,294	12,147	45,890	27,006	33,924

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	20.5	28.2	12.1	13.7	13.6
Adjusted EPS	10.2	14.1	12.1	13.7	13.6
Dividend per share	7.2	9.4	6.0	6.9	6.8
Book value per share	178.8	193.0	107.6	114.4	121.2

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.0	0.7	1.0	0.8	0.8
EV/EBITDA	7.6	5.8	7.3	6.1	6.0
Adjusted P/E	11.9	8.6	10.1	8.9	8.9
P/BV	0.7	0.6	1.1	1.1	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	66.1	67.5	74.8	74.8	74.8
Interest burden (PBT/EBIT)	111.9	117.6	126.6	115.0	109.5
EBIT margin (EBIT/Revenue)	10.8	10.0	10.5	11.0	10.5
Asset turnover (Revenue/Avg TA)	101.4	134.3	83.0	90.8	92.9
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.5
Adjusted ROAE	11.7	15.1	11.8	12.4	11.6

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	11.8	39.6	(31.9)	19.8	9.4
EBITDA	19.1	25.2	(22.5)	21.7	5.1
Adjusted EPS	43.1	38.1	(14.3)	13.8	(0.8)
Profitability & Return ratios (%)					
EBITDA margin	13.3	11.9	13.5	13.8	13.2
EBIT margin	10.8	10.0	10.5	11.0	10.5
Adjusted profit margin	8.0	7.9	10.0	9.5	8.6
Adjusted ROAE	11.7	15.1	11.8	12.4	11.6
ROCE	10.0	12.6	8.8	9.7	9.4
Working capital days (days)					
Receivables	25	18	26	23	23
Inventory	15	12	18	14	14
Payables	24	20	28	24	25
Ratios (x)					
Gross asset turnover	1.3	1.7	1.0	1.1	1.1
Current ratio	1.1	0.9	1.4	1.2	1.3
Net interest coverage ratio	22.6	57.8	16.4	13.3	11.1
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%

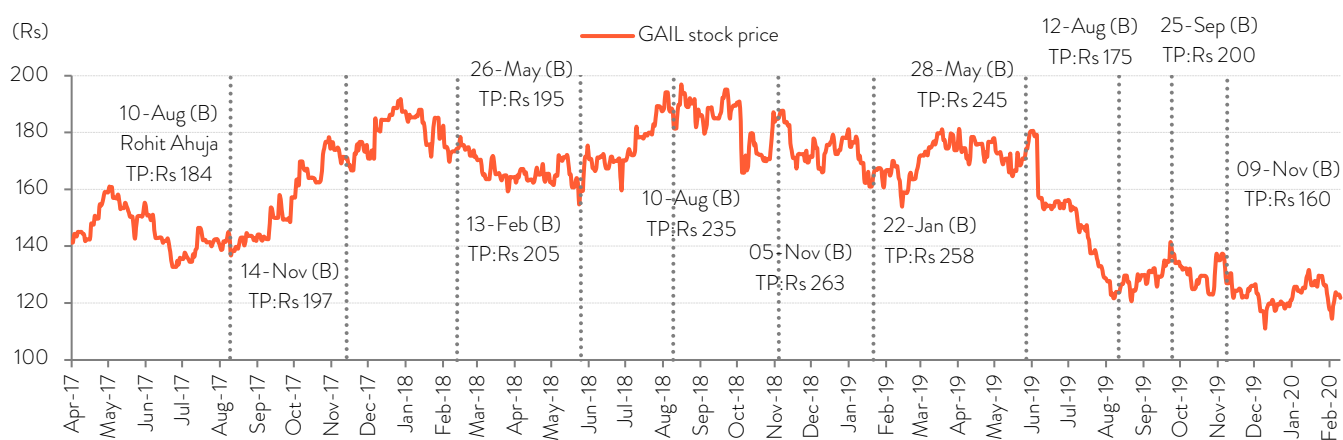
ADD – Expected return from >+5% to +15%

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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