

**BUY**

TP: Rs 155 | ▲ 59%

**GAIL**

Oil & Gas

13 August 2020

## Marketing losses sink earnings

**GAIL's Q1FY21 PAT was below estimates at Rs 2.6bn (-80% YoY). Gross margins underperformed across segments, with EBITDA down 72% YoY. Q1 highlights: (a) gas trading/petchem reported EBITDA losses of Rs 5.2bn/Rs 430mn on low margins and inventory losses, (b) gas transmission EBITDA dipped to Rs 9.5bn (-11% YoY) on lower volumes, (c) LPG production EBITDA beat estimates on low costs. We cut FY21/FY22 earnings by 16.8%/2.4% given weaker gas trading margins and volumes. On rollover, we have a Sep'21 TP of Rs 155 (vs. Rs 150).**

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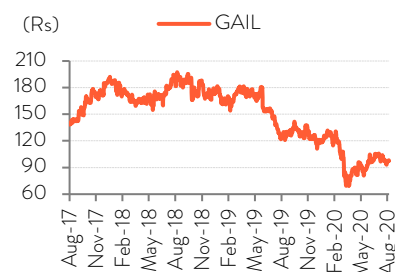
**Lower gas transmission volumes:** Gas transmission volumes at 90mmscmd (-17% QoQ) were below estimates, underperforming the flattish industry consumption trend (~150mmscmd). Management has clarified that volumes are back to >100mmscmd levels in August, though concerns persist on loss of market share for GAIL to other pipelines. The outlook on GAIL's volumes remains buoyant, supported by (a) low spot LNG prices that could accelerate demand recovery, with additional offtake from the power sector, (b) new pipeline commissioning (such as Kochi-Mangaluru and Jagdishpur-Haldia by end-FY22), which could add ~15mmscmd to volumes, and (c) incremental domestic gas production (ONGC/RIL: 20-30mmscmd by FY23/FY24).

Ticker/Price	GAIL IN/Rs 97
Market cap	US\$ 5.9bn
Shares o/s	4,510mn
3M ADV	US\$ 20.7mn
52wk high/low	Rs 149/Rs 65
Promoter/FPI/DII	52%/16%/32%

Source: NSE

**Gas trading margins turn negative:** GAIL's worst fears for its gas trading business came true as it reported a loss of Rs 5.2bn (Rs 2.5bn on inventory, rest on margins). While inventory losses may reverse in Q2/Q3 FY21, margin concerns persist – we thus downgrade our LNG margin estimate to nil for FY21.

## STOCK PERFORMANCE



Source: NSE

**Reiterate BUY:** At 7.4x FY22E EPS, GAIL offers attractive risk-reward, pricing in most of the concerns. Our SOTP target price of Rs 155 builds in worst-case assumptions across segments, especially in gas trading and petrochemicals (which form just ~10% of our valuation).

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	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 (%)	15.1	11.3	10.8	12.6	13.3
Adj. P/E (x)	6.9	8.8	9.1	7.4	6.5
EV/EBITDA (x)	4.6	5.1	6.0	5.1	4.4

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)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>Net sales</b>	<b>120,875</b>	<b>183,106</b>	<b>(34.0)</b>	<b>177,531</b>	<b>(31.9)</b>
Purchase of traded goods	88,318	132,476	(33.3)	133,144	(33.7)
% of sales	73.1	72.3	-	75.0	-
Other expenditure	26,324	28,041	(6.1)	19,634	34.1
% of sales	21.8	15.3	-	11.1	-
<b>EBITDA</b>	<b>6,232</b>	<b>22,590</b>	<b>(72.4)</b>	<b>24,754</b>	<b>(74.8)</b>
<b>EBITDA margin (%)</b>	<b>5.2</b>	<b>12.3</b>	<b>-</b>	<b>13.9</b>	<b>-</b>
Depreciation and amortisation	4,583	4,057	13.0	5,016	(8.6)
<b>EBIT</b>	<b>1,649</b>	<b>18,533</b>	<b>(91.1)</b>	<b>19,738</b>	<b>(91.6)</b>
Interest	495	239	107.0	329	50.3
Other income	2,413	1,512	59.6	5,132	(53.0)
<b>PBT</b>	<b>3,568</b>	<b>19,805</b>	<b>(82.0)</b>	<b>23,525</b>	<b>(84.8)</b>
Provision for tax	1,007	6,930	(85.5)	(4,625)	(121.8)
<b>PAT (adjusted)</b>	<b>2,561</b>	<b>12,875</b>	<b>(80.1)</b>	<b>29,166</b>	<b>(91.2)</b>
<b>NPM (adj.) (%)</b>	<b>2.1</b>	<b>7.0</b>	<b>-</b>	<b>16.4</b>	<b>-</b>
<b>Adjusted EPS (Rs)</b>	<b>0.6</b>	<b>2.9</b>	<b>(80.1)</b>	<b>6.5</b>	<b>(91.2)</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT WISE PERFORMANCE**

Y/E March (Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>Natural Gas Transmission</b>					
Revenue	12,681	14,797	(14.3)	15,542	(18.4)
Volume (mmscmd)	90.22	105.41	(14.4)	108.99	(17.2)
<b>Realisation (Rs/scm)</b>	<b>1.54</b>	<b>1.54</b>	<b>0.1</b>	<b>1.58</b>	<b>(2.5)</b>
<b>EBITDA</b>	<b>9,530</b>	<b>10,680</b>	<b>(10.8)</b>	<b>11,640</b>	<b>(18.1)</b>
PBIT	7,167	8,595	(16.6)	8,920	(19.7)
<b>LPG Transmission</b>					
Revenue	1,536	1,346	14.1	1,719	(10.7)
Volume ('000 MT)	963	827	16.4	1,040	(7.4)
<b>Realisation (Rs/MT)</b>	<b>1,594</b>	<b>1,627</b>	<b>(2.0)</b>	<b>1,653</b>	<b>(3.5)</b>
<b>EBITDA</b>	<b>960</b>	<b>760</b>	<b>26.3</b>	<b>1,100</b>	<b>(12.7)</b>
PBIT	815	616	32.4	945	(13.8)
<b>Natural Gas Trading</b>					
Revenue	94,437	154,613	(38.9)	147,449	(36.0)
Volume (mmscmd)	81.16	96.55	(15.9)	97.76	(17.0)
<b>Realisation (Rs/scm)</b>	<b>12.79</b>	<b>17.60</b>	<b>(27.3)</b>	<b>16.76</b>	<b>(23.7)</b>
<b>EBITDA</b>	<b>(5,170)</b>	<b>8,610</b>	<b>(160.0)</b>	<b>6,310</b>	<b>(181.9)</b>
PBIT	(5,455)	8,505	(164.1)	6,026	(190.5)
<b>Petrochemicals</b>					
Revenue	12,217	11,128	9.8	12,174	0.4
Volume ('000 MT)	183	136	34.6	174	5.2
Realisation (Rs/MT)	66,759	81,821	(18.4)	69,965	(4.6)
<b>Realisation (US\$/MT)</b>	<b>878</b>	<b>1,176</b>	<b>(25.3)</b>	<b>966</b>	<b>(9.1)</b>
<b>EBITDA</b>	<b>(430)</b>	<b>(1,170)</b>	<b>(63.2)</b>	<b>1,850</b>	<b>(123.2)</b>
PBIT (US\$/MT)	(111)	(240)	(53.7)	57	(293.3)

Y/E March (Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>LPG and Liquid HC</b>					
Revenue	7,479	11,457	(34.7)	11,539	(35.2)
Volume ('000 MT)	265	296	(10.5)	302	(12.3)
<b>Realisation (US\$/MT)</b>	<b>371</b>	<b>556</b>	<b>(33.2)</b>	<b>528</b>	<b>(29.6)</b>
<b>EBITDA</b>	<b>2,860</b>	<b>5,460</b>	<b>(47.6)</b>	<b>5,540</b>	<b>(48.4)</b>
PBIT	2,662	5,108	(47.9)	5,281	(49.6)
<b>Others</b>					
Revenue	2,461	2,760	(10.8)	2,883	(14.6)
<b>EBITDA</b>	<b>890</b>	<b>(60)</b>	<b>(1,583.3)</b>	<b>4,460</b>	<b>80.0</b>
PBIT	1,169	1,510	(22.6)	878	33.1
<b>Total Revenues</b>	<b>130,811</b>	<b>196,100</b>	<b>(33.3)</b>	<b>191,305</b>	<b>(31.6)</b>

Source: Company, BOBCAPS Research

## Earnings call highlights

- CNG volumes declined 50% in April and 40% in May from pre-Covid levels. CGD demand dropped to 6mmscmd in Q1FY21 from 40mmscmd the previous quarter and is currently at 15mmscmd. GAIL's peers in the CGD segment were also affected by a massive drop in CNG volumes. However, GAIL is a pan-India supplier and has pipelines running deep into the hinterlands which led to a worse volume slump than peers.
- Offtake from fertiliser and power plants was stable during the quarter. LPG demand and movement were intact and not affected by the Covid situation during the quarter. Consumption reduced for other LHC products such as propylene.
- GAIL is currently operating at 95% (transmission and trading) of FY20 volumes. Its transmission segment is at 109.5mmscmd.
- On average, for the 45 days of Q2FY21 to date, GAIL has been selling 45mscmd of domestic gas and 39mmscmd of R-LNG on an average.
- Urja-Ganga pipeline commissioning is on track with the first phase to be commissioned by Dec'20 and the second phase in FY22. Volumes of 10mmscmd (FY22) and 16mmscmd (FY23) can be potentially added in the first and second phases respectively.
- The Urja-Ganga pipeline's first customer from Gorakhpur is expected to come on board by Sep'20. Refinery customers from Barauni, Paradip and Haldia are expected only after the second phase of commissioning in FY22.
- CGD customers in Patna and Haridwar have already started operations and are waiting for GAIL's Urja-Ganga pipeline connectivity. In the meanwhile, GAIL is using cascades for supplying gas to CNG stations. Pipeline connectivity for other regions will be completed in 12-18 months.
- In the marketing segment, out of the Rs 5bn EBITDA loss, Rs 2.5bn was inventory loss and the remainder was margin loss on high price differentials. In Q2FY21, inventory losses could reverse as spot LNG prices have increased by US\$ 1/mmbtu and long-term R-LNG prices have risen by US\$ 1.5/mmbtu.
- GAIL incurred capex of Rs 60bn during FY20 and expects to spend a similar sum in FY21.

## Valuation methodology

We cut FY21/FY22 earnings estimates by 16.8%/2.4% given weaker gas trading margins and volumes in Q1FY21. Our valuation for the gas trading business halves to Rs 10/sh as we slash margins assumption on LNG sales to nil for FY21 and by 20% for FY22. On rollover, we have a revised Sep'21 target price of Rs 155 (vs. Rs 150).

At 7.4x FY22E EPS, GAIL offers attractive risk-reward, pricing in most of the concerns. Our SOTP target price of Rs 155 builds in worst-case assumptions across segments, especially in gas trading and petrochemicals (which form just ~10% of our valuation. Maintain BUY.

**FIG 3 – REVISED ESTIMATES**

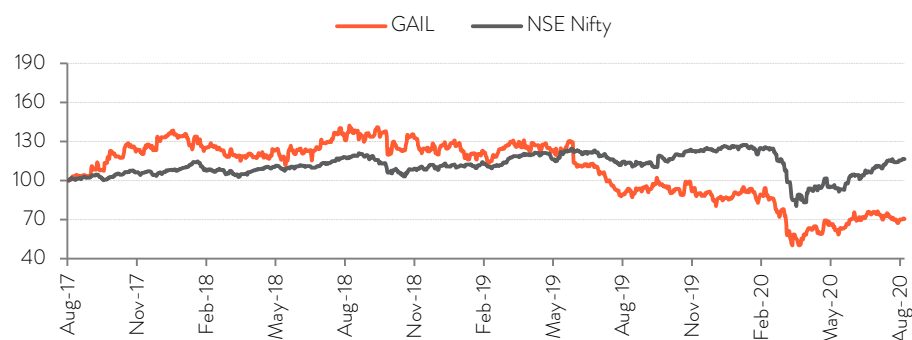
(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	462,382	392,246	(15.2)	536,546	521,799	(2.7)	596,284
EBITDA	90,626	77,833	(14.1)	95,378	92,687	(2.8)	106,713
EBITDA margin (%)	19.6	19.8	-	17.8	17.8	-	17.9
PAT	58,123	48,430	(16.7)	61,167	59,678	(2.4)	67,698
PAT margin (%)	12.6	12.3	-	11.4	11.4	-	11.4
EPS (Rs)	12.9	10.7	(16.8)	13.6	13.2	(2.4)	15.0

Source: BOBCAPS Research

**FIG 4 – 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 Sept'22E EBITDA
LPG & LHC production	141	31	6x Sept'22E EBITDA
Petrochemicals production	36	8	6x Sept'22E EBITDA
Value of investment in listed companies	125	28	20% discount to CMP
Other business valuations	88	20	At book value of investments (OPAL, BCPL, Gail Gas, etc.)
<b>Total EV</b>	<b>720</b>	<b>160</b>	<b>9x FY22E EBITDA</b>
Less: Net debt	15.7	3	FY21 net debt
<b>Equity Value</b>	<b>704</b>	<b>155</b>	<b>Implies ~12x FY22E EPS</b>

Source: BOBCAPS Research

**FIG 5 – RELATIVE STOCK PERFORMANCE**

Source: NSE

**FIG 6 – 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 7 – SEGMENT EBITDA OUTLOOK**

(Rs mn)	FY19	FY20P	FY21E	FY22E	FY23E
<b>Gas transmission</b>	<b>38,884</b>	<b>44,720</b>	<b>50,370</b>	<b>54,750</b>	<b>60,860</b>
% 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
<b>Gas trading</b>	<b>23,694</b>	<b>22,700</b>	<b>1,981</b>	<b>6,711</b>	<b>11,471</b>
% 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
<b>Petrochemicals</b>	<b>8,150</b>	<b>2,050</b>	<b>2,330</b>	<b>5,640</b>	<b>6,254</b>
% 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
<b>LPG &amp; Liquid HC</b>	<b>6,364</b>	<b>6,241</b>	<b>19,955</b>	<b>22,390</b>	<b>24,931</b>
% total segment EBITDA	7.9	7.8	25.6	24.2	23.4
% YoY growth	(73.2)	(1.9)	219.7	12.2	11.3
<b>LPG transmission</b>	<b>3,669</b>	<b>3,900</b>	<b>3,196</b>	<b>3,196</b>	<b>3,196</b>
% 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
<b>Total EBITDA</b>	<b>95,556</b>	<b>84,710</b>	<b>77,833</b>	<b>92,687</b>	<b>106,713</b>

Source: BOBCAPS Research

## 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	FY20P	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>802,836</b>	<b>718,710</b>	<b>392,246</b>	<b>521,799</b>	<b>596,284</b>
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)
<b>Reported net profit</b>	<b>63,525</b>	<b>66,206</b>	<b>48,430</b>	<b>59,678</b>	<b>67,698</b>
Adjustments	0	(16,548)	0	0	0
<b>Adjusted net profit</b>	<b>63,525</b>	<b>49,658</b>	<b>48,430</b>	<b>59,678</b>	<b>67,698</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Accounts payables	39,612	41,284	28,172	30,560	35,271
Other current liabilities	72,060	83,371	83,371	83,371	83,371
Provisions	14,253	12,847	14,283	14,283	14,283
Debt funds	8,706	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	412,787	394,610	410,803	443,626	480,860
Shareholders' fund	435,338	439,711	455,904	488,727	525,961
<b>Total liabilities and equities</b>	<b>614,645</b>	<b>678,731</b>	<b>690,268</b>	<b>730,756</b>	<b>798,407</b>
Cash and cash eq.	12,147	8,039	34,293	15,539	30,115
Accounts receivables	40,602	55,759	30,262	37,116	40,953
Inventories	23,219	29,601	12,573	16,728	19,070
Other current assets	40,509	57,635	60,831	63,600	66,498
Investments	95,282	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
<b>Total assets</b>	<b>614,644</b>	<b>668,288</b>	<b>690,268</b>	<b>730,756</b>	<b>798,407</b>

Source: Company, BOBCAPS Research



**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Net income + Depreciation	79,027	84,566	66,473	79,213	88,701
Changes in working capital	13,085	(27,088)	27,653	(11,389)	(4,367)
Other operating cash flows	(17,081)	(20,478)	10,033	(6,354)	(5,090)
<b>Cash flow from operations</b>	<b>75,030</b>	<b>37,001</b>	<b>104,159</b>	<b>61,470</b>	<b>79,244</b>
Capital expenditures	(75,350)	(57,743)	(48,099)	(60,000)	(60,000)
Change in investments	4,249	20,297	(5,000)	(5,000)	(5,000)
Other investing cash flows	15,448	14,168	10,132	11,632	10,796
<b>Cash flow from investing</b>	<b>(55,653)</b>	<b>(23,278)</b>	<b>(42,967)</b>	<b>(53,368)</b>	<b>(54,204)</b>
Equities issued/Others	0	(1,218)	0	0	0
Debt raised/repaid	(1,055)	54,445	(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
<b>Cash flow from financing</b>	<b>(32,525)</b>	<b>(17,831)</b>	<b>(34,938)</b>	<b>(26,855)</b>	<b>(10,464)</b>
<b>Changes in cash and cash eq.</b>	<b>(13,147)</b>	<b>(4,108)</b>	<b>26,254</b>	<b>(18,754)</b>	<b>14,576</b>
<b>Closing cash and cash eq.</b>	<b>12,147</b>	<b>8,039</b>	<b>34,293</b>	<b>15,539</b>	<b>30,115</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20P	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	193.0	97.5	101.1	108.4	116.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20P	FY21E	FY22E	FY23E
EV/Sales	0.5	0.6	1.2	0.9	0.8
EV/EBITDA	4.6	5.1	6.0	5.1	4.4
Adjusted P/E	6.9	8.8	9.1	7.4	6.5
P/BV	0.5	1.0	1.0	0.9	0.8

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20P	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)	134.3	112.0	57.7	73.4	78.0
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	15.1	11.3	10.8	12.6	13.3

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
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
<b>Profitability &amp; Return ratios (%)</b>					
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	15.1	11.3	10.8	12.6	13.3
ROCE	12.6	11.7	8.9	10.5	11.3
<b>Working capital days (days)</b>					
Receivables	18	24	40	24	24
Inventory	12	17	30	14	15
Payables	20	23	40	25	25
<b>Ratios (x)</b>					
Gross asset turnover	1.7	1.4	0.7	0.8	0.8
Current ratio	0.9	0.9	1.1	1.0	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%

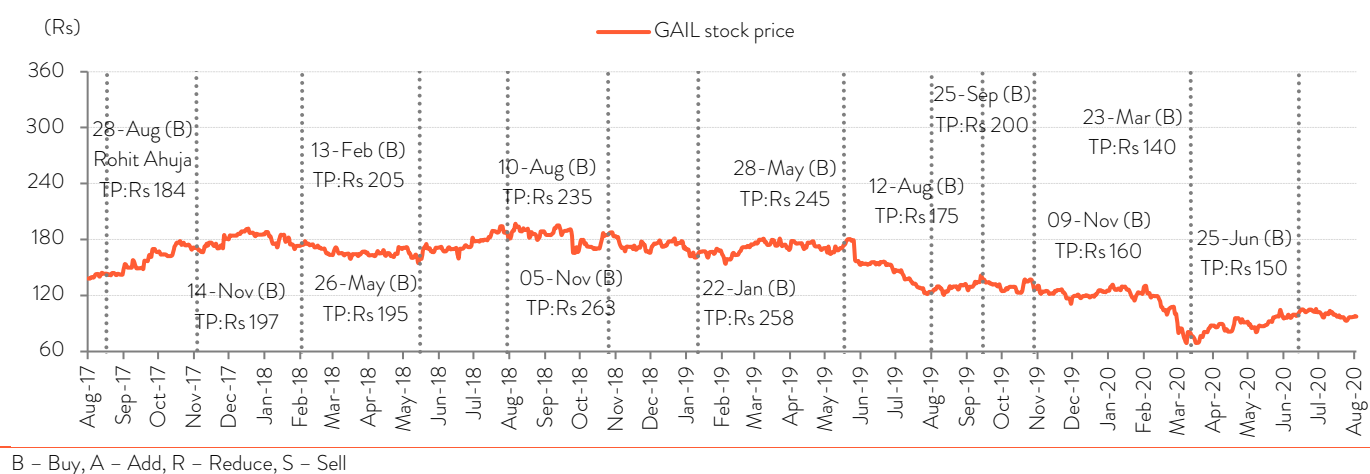
**ADD** – Expected return from >+5% to +15%

**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)



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