

BUY

TP: Rs 160 | ▲ 26%

GAIL

Oil & Gas

09 November 2019

Trading earnings slump

GAIL's Q2FY20 PAT was well below estimates at Rs 10.6bn (-42% YoY). Gross margins underperformed across segments, barring LPG/LHC production. Key Q2 highlights: (a) gas trading EBITDA tanked 75% YoY on lower margins, (b) gas transmission volumes fell short of estimates at 109mmscmd, and (c) LPG EBITDA outperformed. We reduce FY20/FY21/FY22 earnings by 9.5%/7.6%/13.1% to factor in lower gas trading and transmission profits. This translates to a new Sep'20 TP of Rs 160 (from Rs 200).

Rohit Ahuja | Harleen Manglani

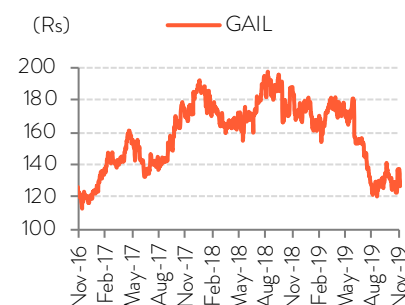
research@bobcaps.in

Gas transmission volumes miss estimates but outlook robust: Q2 gas transmission volumes were lower than expected at ~109mmscmd (+2.6% YoY). Tariffs were also lower at Rs 1.41/scm (-9.9% YoY) as revenues carry a one-off expense of Rs 1.9bn. We remain positive on GAIL's volume outlook supported by (a) improving LNG offtake potential from new regasification capacities (Petronet LNG Dahej has added ~5mmscmd from Q2FY20), and (b) incremental domestic gas production (ONGC/RIL: 20-30mmscmd by FY22).

Ticker/Price	GAIL IN/Rs 127
Market cap	US\$ 8.0bn
Shares o/s	4,510mn
3M ADV	US\$ 19.1mn
52wk high/low	Rs 190/Rs 120
Promoter/FPI/DII	53%/19%/29%

Source: NSE

STOCK PERFORMANCE



Source: NSE

Gas trading disappoints: Q2 gas trading EBITDA at Rs 2.5bn (-75% YoY) declined on lower margins from US LNG, despite management's assurances that hedges/swaps for US volumes would provide a floor to trading margins. These levels of EBITDA may continue over 2-3 quarters until the new fertiliser units that have contracted US LNG (~6mmscmd) come onstream.

Concerns priced in; reiterate BUY: At 9.3x 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 TP 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	605,598	701,945	769,572
EBITDA (Rs mn)	76,339	95,556	80,708	96,982	102,802
Adj. net profit (Rs mn)	46,000	63,525	56,278	62,048	61,809
Adj. EPS (Rs)	10.2	14.1	12.5	13.8	13.7
Adj. EPS growth (%)	43.1	38.1	(11.4)	10.3	(0.4)
Adj. ROAE (%)	11.7	15.1	12.6	13.0	12.1
Adj. P/E (x)	12.5	9.0	10.2	9.2	9.3
EV/EBITDA (x)	7.7	5.8	7.1	6.2	6.1

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

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Net sales	1,80,399	1,91,423	(5.8)	1,83,106	(1.5)	3,63,505	3,65,739	(0.6)
Purchase of traded goods	1,36,220	1,36,176	0.0	1,32,476	2.8	2,68,696	2,66,399	0.9
% of sales	75.5	71.1	-	72.3	-	73.9	72.8	-
Other expenditure	28,552	27,302	4.6	28,041	1.8	56,593	47,364	19.5
% of sales	15.8	14.3	-	15.3	-	15.6	13.0	-
EBITDA	15,627	27,946	(44.1)	22,590	(30.8)	38,217	51,975	(26.5)
EBITDA margin (%)	8.7	14.6	-	12.3	-	10.5	14.2	-
Depreciation and amortisation	4,398	3,506	25.4	4,057	8.4	8,455	7,294	15.9
EBIT	11,229	24,440	(54.1)	18,533	(39.4)	29,762	44,681	(33.4)
Interest	275	455	(39.5)	239	15.0	514	896	(42.6)
Other income	4,401	3,656	20.4	1,512	191.1	5,913	4,589	28.8
PBT	15,355	27,642	(44.4)	19,805	(22.5)	35,160	48,374	(27.3)
Provision for tax	4,713	9,342	(49.6)	6,930	(32.0)	11,643	16,152	(27.9)
PAT (adjusted)	10,643	18,300	(41.8)	12,875	(17.3)	23,518	32,222	(27.0)
NPM (adj.) (%)	5.9	9.6	-	7.0	-	6.5	8.8	-
Adjusted EPS (Rs)	2.4	8.1	(70.9)	2.9	(17.3)	5.2	14.3	(63.5)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT-WISE PERFORMANCE

Y/E March (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20E	H1FY19	YoY (%)
Natural Gas Transmission								
Revenue	14,150	15,308	(7.6)	14,797	(4.4)	58,459	28,423	105.7
Volume (mmscmd)	108.70	105.90	2.6	105.41	3.1	108.04	106.47	1.5
Realisation (Rs/scm)	1.41	1.57	(9.9)	1.54	(8.3)	1.48	1.46	1.2
EBITDA	10,200	10,810	(5.6)	10,680	(4.5)	20,880	19,890	5.0
PBIT	8,028	8,945	(10.3)	8,595	(6.6)	16,622	15,973	4.1
LPG Transmission								
Revenue	1,612	1,524	5.8	1,346	19.8	6,032	2,934	105.6
Volume ('000 MT)	999	1,015	(1.6)	827	20.8	1,826	1,916	(4.7)
Realisation (Rs/MT)	1,613	1,501	7.5	1,627	(0.9)	1,656	1,531	8.2
EBITDA	960	790	21.5	760	26.3	1,720	1,590	8.2
PBIT	814	653	24.6	616	32.2	1,429	1,307	9.4
Natural Gas Trading								
Revenue	1,50,858	1,56,519	(3.6)	1,54,613	(2.4)	6,32,423	2,96,866	113.0
Volume (mmscmd)	94.70	96.20	(1.6)	96.55	(1.9)	95.75	96.68	(1.0)
Realisation (Rs/scm)	17.32	17.68	(2.1)	17.60	(1.6)	16.97	16.78	1.1
EBITDA	2,540	10,450	(75.7)	8,610	(70.5)	11,150	15,960	(30.1)
PBIT	2,366	10,448	(77.4)	8,505	(72.2)	10,871	15,961	(31.9)
Petrochemicals								
Revenue	16,192	17,722	(8.6)	11,128	45.5	52,724	33,856	55.7
Volume ('000 MT)	228	195	16.9	136	67.6	364	361	0.8
Realisation (Rs/MT)	71,016	90,881	(21.9)	81,821	(13.2)	79,964	93,783	(14.7)
Realisation (US\$/MT)	960	1,206	(20.4)	1,176	(18.4)	1,129	1,318	(14.3)
EBITDA	320	2,750	(88.4)	(1,170)	-	(850)	5,880	-
PBIT (US\$/MT)	(823)	1,674	-	(2,270)	(63.7)	(1,321)	3,752	-

Y/E March (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20E	H1FY19	YoY (%)
LPG and Liquid HC								
Revenue	9,605	13,766	(30.2)	11,457	(16.2)	42,854	24,491	75.0
Volume ('000 MT)	329	338	(2.7)	296	11.1	625	652	(4.1)
Realisation (US\$/MT)	395	541	(27.0)	556	(29.1)	467	528	(11.5)
EBITDA	2,730	7,830	(65.1)	5,460	(50.0)	8,190	13,290	(38.4)
PBIT	2,454	7,671	(68.0)	5,108	(52.0)	7,561	12,972	(42)
Others								
Revenue	2,890	712	305.8	2,760	4.7	8,357	3,005	178.1
EBITDA	3,260	300	986.7	(60)	5,533.3	3,260	(50)	-
PBIT	1,767	460	283.9	1,510	17.0	3,278	1,308	150.6
Total Revenues	1,95,307	2,05,551	(5.0)	1,96,100	(0.4)	8,00,848	3,89,574	105.6

Source: Company, BOBCAPS Research

Earnings call highlights

Gas trading

- Out of 95mmscmd of gas trading volumes, 44mmscmd is domestic (APM gas), 3.8mmscmd PMT, 23mmscmd RLNG (Dahej), 10.5mmscmd of US LNG is being sold internationally, 7.1mmscmd of US LNG is being sold in India, and 6.6mmscmd is spot.
- GAIL has committed to offtake 90 US LNG cargoes in FY20, of which 43 have been imported in H1FY20.
- Trading EBITDA declined on account of losses incurred on discount sale of ~6mmscmd of US LNG that was committed over the long term to a greenfield fertiliser unit, commissioning of which has been delayed.

Gas transmission

- Volumes could pick up post commissioning of the Kochi-Mangalore (in Q4FY20) and Jagdishpur-Haldia (H2FY21) pipelines. These could add ~5mmscmd of volumes in FY21.
- Power sector demand could pick up if low spot LNG prices continue.

Valuation methodology

We reduce FY20/FY21/FY22 earnings by 9.5%/7.6%/13.1% on factoring in lower gas trading and transmission earnings. This translates to a new Sep'20 target price of Rs 160 (from Rs 200).

At 9.3x 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 TP of Rs 160 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	6,26,416	6,05,598	(3.3)	7,24,423	7,01,945	(3.1)	7,94,785	7,69,572	(3.2)
EBITDA	1,04,847	80,708	(23.0)	1,20,553	96,982	(19.6)	1,29,109	1,02,802	(20.4)
EBITDA margin (%)	16.7	13.3	-	13.3	13.8	-		13.4	-
PAT	62,170	56,278	(9.5)	67,143	62,048	(7.6)	71,113.0	61,809	(13.1)
PAT margin (%)	9.9	9.3	-	7.8	8.8	-		8.0	-
EPS (Rs)	13.8	12.5	(9.5)	14.9	13.8	(7.6)	15.5	13.7	(13.1)

Source: BOBCAPS Research

FIG 4 – SOTP VALUATION SUMMARY

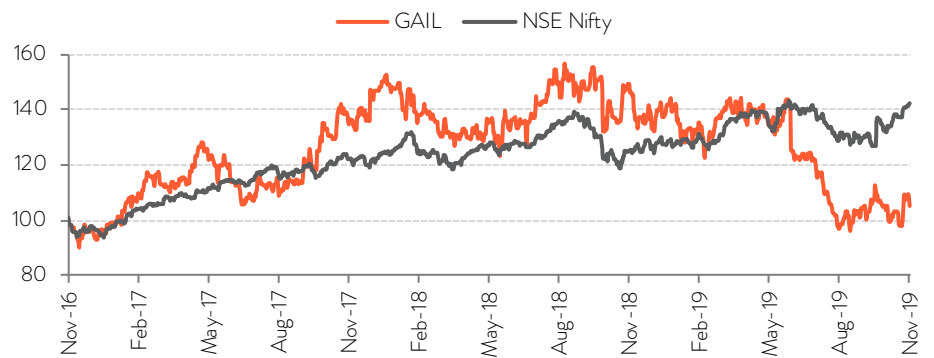
Details	Value (Rs bn)	Value (Rs/sh)	Description
Natural gas and LPG transmission	219	48	DCF
Gas trading	116	26	5x Sep'21E EBITDA
LPG & LHC production	141	31	6x Sep'21E EBITDA
Petrochemicals production	25	5	6x Sep'21E EBITDA
Value of investment in listed companies	152	34	20% discount to CMP
Other business valuations	98	22	At book value of investments (OPAL, BCPL, Gail Gas, etc.)
Total EV	750	166	8.4x FY22E EBITDA
Less: Net debt	32	7	
Equity Value	718	160	Implies ~11.6x 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)	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)	850	950	950
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 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	605,598	701,945	769,572
EBITDA	76,339	95,556	80,708	96,982	102,802
Depreciation	(14,151)	(15,502)	(16,533)	(18,043)	(19,535)
EBIT	62,188	80,054	64,176	78,939	83,267
Net interest income/(expenses)	(2,751)	(1,385)	(3,506)	(5,425)	(6,751)
Other income/(expenses)	9,870	15,448	14,568	9,439	6,117
Exceptional items	277	0	0	0	0
EBT	69,307	94,116	75,238	82,952	82,633
Income taxes	(23,400)	(30,591)	(18,960)	(20,904)	(20,824)
Reported net profit	46,184	63,525	56,278	62,048	61,809
Adjusted net profit	46,000	63,525	56,278	62,048	61,809

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	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	53,501	55,006	80,006
Other liabilities	46,309	44,676	46,640	46,640	46,640
Equity capital	22,551	22,551	45,101	45,101	45,101
Reserves & surplus	380,731	412,787	416,390	449,401	482,285
Shareholders' fund	403,281	435,338	461,491	494,502	527,386
Total liabilities and equities	580,822	614,645	682,288	722,788	785,535
Cash and cash eq.	25,294	12,147	21,413	4,498	13,306
Accounts receivables	40,515	40,602	41,629	46,435	49,998
Inventories	19,195	23,219	19,334	22,341	24,485
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	682,288	722,788	785,535

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	63,621	79,027	72,810	80,091	81,345
Changes in working capital	26,994	13,085	(20,090)	(4,474)	(3,611)
Other operating cash flows	(1,066)	(17,081)	(12,604)	(9,439)	(6,117)
Cash flow from operations	89,548	75,030	40,117	66,179	71,617
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	14,568	9,439	6,117
Cash flow from investing	(33,268)	(55,653)	(45,523)	(55,561)	(58,883)
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)	(52,674)	(29,037)	(28,926)
Other financing cash flows	(8,070)	(5,416)	3,506	5,425	6,751
Cash flow from financing	(44,404)	(32,525)	14,672	(27,532)	(3,926)
Changes in cash and cash eq.	11,875	(13,147)	9,266	(16,914)	8,808
Closing cash and cash eq.	25,294	12,147	21,413	4,498	13,306

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	20.5	28.2	12.5	13.8	13.7
Adjusted EPS	10.2	14.1	12.5	13.8	13.7
Dividend per share	7.2	9.4	10.0	5.5	5.5
Book value per share	178.8	193.0	102.3	109.6	116.9

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.0	0.7	0.9	0.9	0.8
EV/EBITDA	7.7	5.8	7.1	6.2	6.1
Adjusted P/E	12.5	9.0	10.2	9.2	9.3
P/BV	0.7	0.7	1.2	1.2	1.1

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	117.2	105.1	99.2
EBIT margin (EBIT/Revenue)	10.8	10.0	10.6	11.2	10.8
Asset turnover (Revenue/Avg TA)	101.4	134.3	93.4	99.9	102.0
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.5	1.5
Adjusted ROAE	11.7	15.1	12.6	13.0	12.1

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	(24.6)	15.9	9.6
EBITDA	19.1	25.2	(15.5)	20.2	6.0
Adjusted EPS	43.1	38.1	(11.4)	10.3	(0.4)
Profitability & Return ratios (%)					
EBITDA margin	13.3	11.9	13.3	13.8	13.4
EBIT margin	10.8	10.0	10.6	11.2	10.8
Adjusted profit margin	8.0	7.9	9.3	8.8	8.0
Adjusted ROAE	11.7	15.1	12.6	13.0	12.1
ROCE	10.0	12.6	10.0	11.1	10.8
Working capital days (days)					
Receivables	25	18	25	23	23
Inventory	15	12	17	14	14
Payables	24	20	27	25	25
Ratios (x)					
Gross asset turnover	1.3	1.7	1.1	1.1	1.1
Current ratio	1.1	0.9	1.2	1.1	1.2
Net interest coverage ratio	22.6	57.8	18.3	14.6	12.3
Adjusted debt/equity	0.0	0.0	0.1	0.1	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

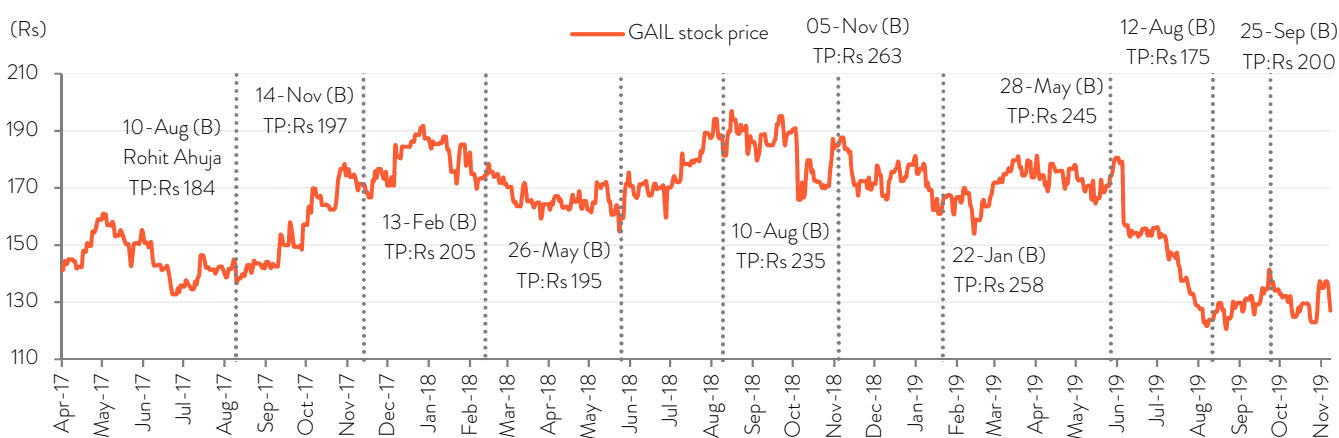
ADD – Expected return from >+5% to +15%

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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