

BUY

TP: Rs 160 | ▲ 22%

GAIL

Oil & Gas

10 February 2021

Cyclicals bolster earnings

GAIL's Q3FY21 PAT was in line at Rs 14.9bn (+24% YoY) aided by an improved operating performance across segments (ex-trading). Q3 highlights: (a) gas trading continued to report losses (Rs 0.45bn), and (b) gas transmission and petchem earnings outperformed at Rs 12.5bn (+2.2% YoY) and Rs 5.5bn (5x YoY) respectively on higher volumes and margins. Pipeline commissioning and higher oil prices lift the outlook across the natural gas, petchem and LPG segments. We adjust FY21/FY22 EPS by -6%/+6% and roll to a Mar'22 TP of Rs 160 (vs. Rs 155).

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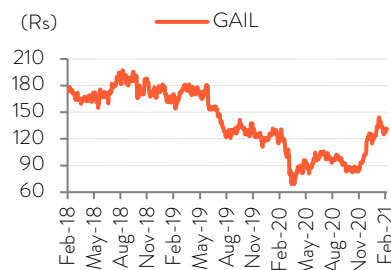
V-shaped volume recovery: Gas transmission volumes were in line with our estimates at 110mmscmd (flat YoY, +3.6% QoQ). GAIL's existing capacity utilisation remains muted at ~50%. However, new pipeline commissioning (Kochi-Mangaluru and Jagdishpur-Haldia) carries ~15mmscmd of incremental volume potential by FY23. These pipelines coupled with incremental supply potential from upcoming LNG regasification capacities (~50mmscmd) and domestic gas production (ONGC/RIL: 20-30mmscmd) could add 20-30mmscmd to GAIL's gas transmission/trading volumes by FY24/FY25.

Ticker/Price	GAIL IN/Rs 131
Market cap	US\$ 8.1bn
Shares o/s	4,510mn
3M ADV	US\$ 43.2mn
52wk high/low	Rs 146/Rs 65
Promoter/FPI/DII	52%/15%/33%

Source: NSE

Petchem earnings skyrocket; trading margins still negative: Petrochemical earnings jumped 5x YoY owing to better margins as PE prices improved along with >100% utilisation of crackers. On the other hand, the gas trading business sustained losses. LPG/LHC earnings were in line at Rs 3bn (-4.4% YoY). The recent rise in oil prices is likely to further boost cyclical segment earnings in Q4.

STOCK PERFORMANCE



Source: NSE

Reiterate BUY: The stock rally over the past three months has elevated GAIL's valuation to 8.8x FY23E EPS from ~6x in Nov'20. Risk-reward still remains attractive as oil prices rise. We trim FY21 EPS by 6% but raise FY22 estimates by 6% on higher petchem segment earnings. Gas trading earnings could turn around from Q4 on higher spot LNG prices.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	802,836	718,710	494,274	768,062	848,231
EBITDA (Rs mn)	95,556	84,710	73,582	96,970	105,985
Adj. net profit (Rs mn)	63,525	49,658	45,681	63,466	67,512
Adj. EPS (Rs)	14.1	11.0	10.1	14.1	15.0
Adj. EPS growth (%)	38.1	(21.8)	(8.0)	38.9	6.4
Adj. ROAE (%)	15.0	11.3	10.2	13.4	13.2
Adj. P/E (x)	9.3	11.9	12.9	9.3	8.8
EV/EBITDA (x)	6.2	6.9	8.4	6.4	5.8

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)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Net sales	154,543	177,673	(13.0)	136,427	13.3	411,839	542,333	(24.1)
Purchase of traded goods	107,504	133,632	(19.6)	95,369	12.7	291,191	402,645	(27.7)
% of sales	69.6	75.2	-	69.9	-	70.7	74.2	-
Other expenditure	27,844	23,318	19.4	27,677	0.6	81,845	79,758	2.6
% of sales	18.0	13.1	-	20.3	-	19.9	14.7	-
EBITDA	19,195	20,724	(7.4)	13,381	43.4	38,803	59,930	(35.3)
EBITDA margin (%)	12.4	11.7	-	9.8	-	9.4	11.1	-
Depreciation and amortisation	4,895	5,349	(8.5)	4,843	1.1	14,321	13,803	3.8
Interest	331	242	37.1	274	20.7	1,101	820	34.2
Other income	4,708	3,124	50.7	7,239	(35.0)	14,361	7,872	82.4
PBT	18,677	18,257	2.3	15,503	20.5	37,742	53,179	(29.0)
Provision for tax	3,804	6,210	(38.7)	3,107	22.4	7,917	19,511	(59.4)
Effective tax rate	20.4	34.0	-	20.0	-	21.0	36.7	-
PAT (adjusted)	14,873	12,048	23.5	12,397	20.0	29,825	33,669	(11.4)
NPM (adj.) (%)	9.6	6.8	-	9.1	-	7.2	6.2	-
Adjusted EPS (Rs)	3.3	2.7	23.5	2.7	20.0	6.6	7.5	(11.4)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENTAL PERFORMANCE

Y/E March (Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Natural Gas Transmission								
Revenue	16,135	15,855	1.8	15,400	4.8	44,216	74,314	(40.5)
Volume (mmscmd)	110.30	110.30	-	106.44	3.6	104.32	109.17	(4.4)
Realisation (Rs/scm)	1.59	1.56	1.8	1.57	1.1	1.57	1.52	3.1
Gross margins	12,470	12,200	2.2	12,810	(2.7)	34,810	33,080	5.2
PBIT	9,907	10,297	(3.8)	10,212	(3.0)	27,285	26,477	3.0
LPG Transmission								
Revenue	1,754	1,688	3.9	1,695	3.5	4,984	7,719	(35.4)
Volume ('000 MT)	1,088	1,043	4.3	1,058	2.8	3,109	2,869	8.4
Realisation (Rs/MT)	1,612	1,618	(0.4)	1,602	0.6	1,603	1,637	(2.1)
Gross margins	1,090	1,080	0.9	1,030	5.8	3,080	2,800	10.0
PBIT	931	680	36.9	882	5.6	2,629	2,364	11.2
Natural Gas Trading								
Revenue (Rs mn)	119,034	171,576	(30.6)	105,067	13.3	318,538	803,999	(60.4)
Volume (mmscmd)	95.60	96.00	(0.4)	88.60	7.9	90.24	95.88	(5.9)
Realisation (Rs/scm)	13.53	19.43	(30.3)	12.89	5.0	12.84	18.20	(29.5)
Gross margins	(450)	5,240	-	(3,350)	-	(8,970)	16,390	-
PBIT (Rs mn)	(737)	5,240	-	(3,640)	-	(9,831)	15,397	-
Petrochemicals								
Revenue (Rs mn)	19,366	12,770	51.7	16,847	15.0	48,430	67,552	(28.3)
Volume ('000 MT)	231	211	9.5	221	4.5	635	575	10.4
Realisation (Rs/MT)	83,836	60,520	38.5	76,232	10.0	76,268	75,120	1.5
Realisation (US\$/MT)	1,136	850	33.6	1,025	10.9	1,024	1,056	(3.0)
Gross margins	5,490	1,050	422.9	2,890	90.0	7,950	200	3,875.0
PBIT (Rs mn)	4,341	2,413	79.9	1,763	146.2	4,560	(1,406)	-
LPG and Liquid HC								
Revenue (Rs mn)	8,779	10,307	(14.8)	8,030	9.3	24,288	52,590	(53.8)
Volume ('000 MT)	319	329	(3.0)	293	8.9	877	962	(8.8)
Realisation (US\$/MT)	373	440	(15.3)	368	1.2	372	435	(14.6)
Gross margins	3,040	3,180	(4.4)	3,020	0.7	8,920	11,370	(21.5)
PBIT (Rs mn)	2,827	1,733	63.2	2,802	0.9	8,291	10,525	(21)
Others								
Revenue (Rs mn)	2,633	2,000	31.6	2,267	16.1	7,361	8,376	(12.1)
Gross margins	2,270	3,260	(30.4)	4,220	46.2	7,380	4,360	69.3
PBIT (Rs mn)	1,017	1,510	(32.7)	913	11.4	3,099	4,616	(32.9)
Total Revenues	167,700	214,196	(21.7)	149,306	12.3	447,817	1,014,551	(55.9)

Source: Company, BOBCAPS Research

Valuation methodology

The recent stock rally has elevated GAIL's valuation to 8.8x FY23E EPS from ~6x in Nov'20. In our view, risk-reward still remains attractive as oil prices rise. Gas trading earnings could turn around from Q4FY21 given higher spot LNG prices. Further, new pipeline commissioning and higher oil prices lift the outlook across the natural gas, petchem and LPG segments. We trim FY21 EPS by 6% but raise FY22 estimates by 6% on higher petchem segment earnings. On rollover, we move to a revised Mar'22 target price of Rs 160 (from Rs 155). Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	392,246	494,274	26.0	521,799.1	768,062	47.2	596,284	848,231	42.3
EBITDA	77,833	73,582	(5.5)	92,687.0	96,970	4.6	106,713	105,985	(0.7)
EBITDA margin (%)	19.8	14.9	-	17.8	12.6	-	17.9	12.5	-
PAT	48,430	45,681	(5.7)	59,677.8	63,466	6.3	67,698	67,512	(0.3)
PAT margin (%)	12.3	9.2	-	11.4	8.3	-	11.4	8.0	-
EPS (Rs)	10.7	10.1	(5.7)	13.2	14.1	6.3	15.0	15.0	(0.3)

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 FY23E EBITDA respectively
Gas trading	45	13	5x FY23E EBITDA
LPG & LHC production	130	29	6x FY23E EBITDA
Petrochemicals production	52	12	6x FY23E 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	733	163	-
Less: Net debt	13	3	-
Equity Value	720	160	Implies ~11.3x FY23E EPS

Source: BOBCAPS Research

FIG 5 – KEY ASSUMPTIONS

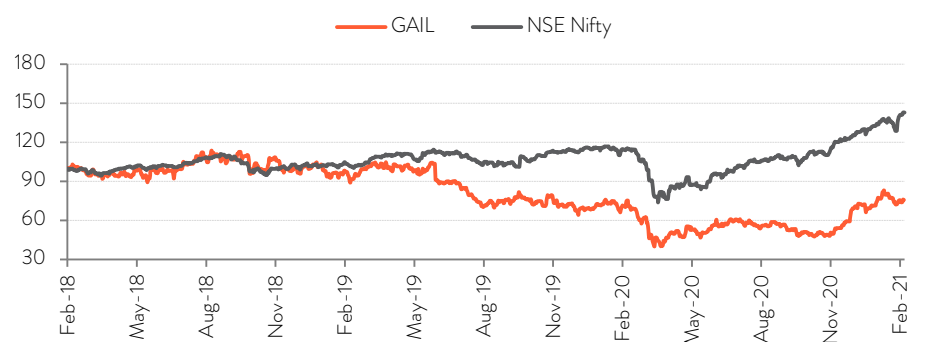
	FY21E	FY22E	FY23E
Gas transmission volumes (mmscmd)	115	125	140
Transmission tariffs (Rs/scm)	1.50	1.50	1.50
Gas trading volumes (mmscmd)	90	110	110
Gas trading margins on LNG (Rs/scm)	(0.25)	0.2	0.2
PE sales volumes (000 tpa)	800	800	800
Gross PE realisation (US\$/MT)	1,121	1,300	1,350
LPG/LHC sales volumes (000 tpa)	1,453	1,453	1,453
Gross LPG/LHC realisation (US\$/MT)	350	375	400

Source: BOBCAPS Research

FIG 6 – 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	68.5	56.5	57.4
% YoY growth	7.0	15.0	12.6	8.7	11.2
Gas trading	23,694	22,700	(7,529)	11,185	11,471
% total segment EBITDA	29.3	28.5	(10.2)	11.5	10.8
% YoY growth	88.8	(4.2)	(133.2)	(248.5)	2.6
Petrochemicals	8,150	2,050	9,912	8,626	8,784
% total segment EBITDA	10.1	2.6	13.5	8.9	8.3
% YoY growth	18.3	(74.8)	383.5	(13.0)	1.8
LPG & Liquid HC	6,364	6,241	17,633	19,214	21,673
% total segment EBITDA	7.9	7.8	24.0	19.8	20.4
% YoY growth	(73.2)	(1.9)	182.5	9.0	12.8
LPG transmission	3,669	3,900	3,196	3,196	3,196
% total segment EBITDA	4.5	4.9	4.3	3.3	3.0
% YoY growth	12.5	6.3	(18.0)	0.0	0.0
Total EBITDA	95,556	84,710	73,582	96,970	105,985

Source: BOBCAPS Research

FIG 7 – 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
- 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	494,274	768,062	848,231
EBITDA	95,556	84,710	73,582	96,970	105,985
Depreciation	(15,502)	(18,360)	(18,043)	(19,535)	(21,003)
EBIT	80,054	66,350	55,539	77,435	84,982
Net interest income/(expenses)	(1,385)	(1,085)	(5,175)	(5,001)	(6,001)
Other income/(expenses)	15,448	14,168	10,708	12,413	11,275
EBT	94,116	79,434	61,071	84,848	90,257
Income taxes	(30,591)	(13,227)	(15,390)	(21,382)	(22,745)
Reported net profit	63,525	66,206	45,681	63,466	67,512
Adjustments	0	(16,548)	0	0	0
Adjusted net profit	63,525	49,658	45,681	63,466	67,512

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	39,612	41,284	40,404	50,762	56,397
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	58,590	63,843	69,483
Equity capital	22,551	45,101	45,101	45,101	45,101
Reserves & surplus	418,378	394,610	411,396	446,302	483,434
Shareholders' fund	440,929	439,711	456,497	491,404	528,535
Total liabilities and equities	627,687	676,626	701,047	751,563	819,970
Cash and cash eq.	12,147	8,039	37,172	16,566	31,482
Accounts receivables	50,743	55,759	35,144	49,399	53,497
Inventories	23,219	29,601	15,591	24,225	26,722
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	701,047	751,563	819,970

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	79,027	84,566	63,724	83,001	88,515
Changes in working capital	4,138	(20,246)	31,985	(15,299)	(3,859)
Other operating cash flows	(17,081)	(20,478)	9,516	(7,161)	(5,635)
Cash flow from operations	66,084	43,842	105,225	60,541	79,021
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	10,708	12,413	11,275
Cash flow from investing	(56,611)	(22,320)	(42,391)	(52,587)	(53,725)
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)	(20,557)	(28,560)	(30,380)
Other financing cash flows	(5,416)	(40,842)	5,175	5,001	6,001
Cash flow from financing	(25,073)	(25,282)	(33,701)	(28,560)	(10,380)
Changes in cash and cash eq.	(15,600)	(3,760)	29,133	(20,606)	14,916
Closing cash and cash eq.	9,694	8,387	37,172	16,566	31,482

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	28.2	14.7	10.1	14.1	15.0
Adjusted EPS	14.1	11.0	10.1	14.1	15.0
Dividend per share	9.4	6.5	4.6	6.3	6.7
Book value per share	195.5	97.5	101.2	109.0	117.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.7	0.8	1.3	0.8	0.7
EV/EBITDA	6.2	6.9	8.4	6.4	5.8
Adjusted P/E	9.3	11.9	12.9	9.3	8.8
P/BV	0.7	1.3	1.3	1.2	1.1

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	110.0	109.6	106.2
EBIT margin (EBIT/Revenue)	10.0	9.2	11.2	10.1	10.0
Asset turnover (Revenue/Avg TA)	133.2	111.2	72.2	105.7	107.9
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	15.0	11.3	10.2	13.4	13.2

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)	(31.2)	55.4	10.4
EBITDA	25.2	(11.4)	(13.1)	31.8	9.3
Adjusted EPS	38.1	(21.8)	(8.0)	38.9	6.4
Profitability & Return ratios (%)					
EBITDA margin	11.9	11.8	14.9	12.6	12.5
EBIT margin	10.0	9.2	11.2	10.1	10.0
Adjusted profit margin	7.9	6.9	9.2	8.3	8.0
Adjusted ROAE	15.0	11.3	10.2	13.4	13.2
ROCE	12.4	11.5	8.2	11.1	11.2
Working capital days (days)					
Receivables	21	27	34	20	22
Inventory	12	17	22	12	14
Payables	20	23	35	25	26
Ratios (x)					
Gross asset turnover	1.7	1.4	0.8	1.1	1.2
Current ratio	0.9	0.9	1.1	1.1	1.2
Net interest coverage ratio	57.8	61.2	10.7	15.5	14.2
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%

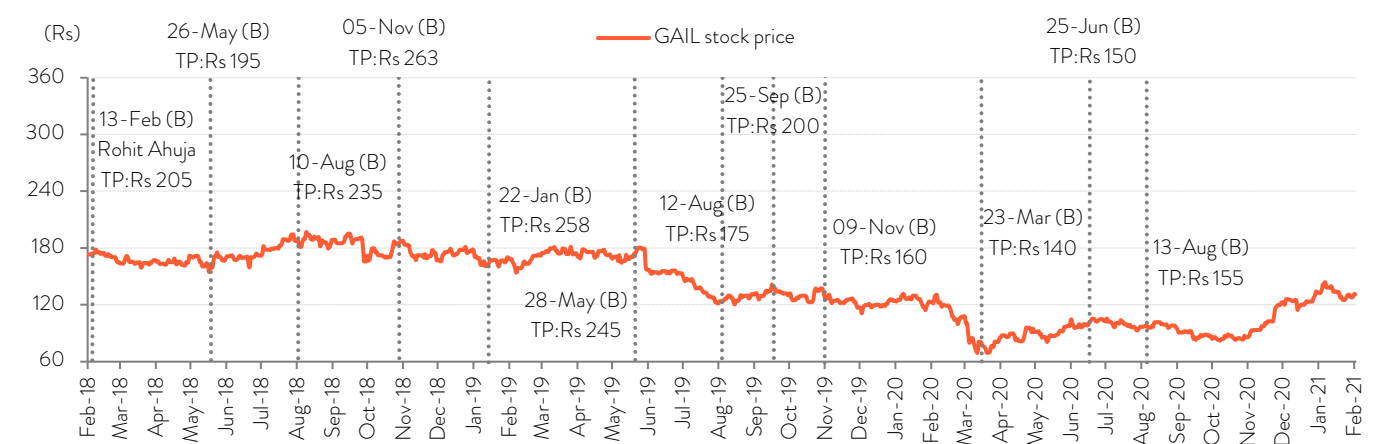
ADD – Expected return from >+5% to +15%

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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