Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

GAIL (India) Ltd

Multiple earnings growth catalyst; valuation attractive

Oil & Gas		Sharekhan code: GAIL		
Reco/View: Buy	↔	CMP: **Rs. 122**	Price Target: **Rs. 150**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We reiterate our Buy rating on GAIL with an increased PT of Rs. 150 (rollover of valuation to Sep'25) given our expectation of 29% PAT CAGR over FY24-26E, healthy RoE of 16% and attractive valuation of 6.6x/5.9x FY25E/FY26E EV/EBITDA. Strong gas transmission volume/tariff outlook, soft global LNG price and gradual recovery in LPG/petchem prices are key triggers for earnings growth.
- We believe superior gas transmission volume growth (management guidance of 124 mmscmd/140 mmscmd by FY24/FY26) and potential further tariff hike in transmission tariff post recent 33% increase would boost gas transmission EBITDA.
- Improving LPG price (given rise in propane price) and cap on APM gas price would drive a strong recovery in the earnings of LPG-LHC. Petchem segment to turnaround gradually given improved utilisation, a recent marginal uptick in HDPE price and soft LNG prices.
- GAIL's US LNG contracts (5.8mtpa) are available at a steep discount to Asian spot LNG price of ~$14-15/mmBtu, and the same augurs well for strong margin-led earnings (management guidance of Rs3,500 crore) for gas marketing business.

GAIL has multiple earnings growth tailwinds across its business segments – 1) gas transmission to benefit from higher tariff/volumes, 2) sustained robust gas marketing margin given US LNG contracts are available at steep discount to Asian spot LNG price, 3) petchem to turnaround on improved utilization, soft LNG price and gradual improvement in realisation and 4) LPG-LHC margin to improve from APM gas price cap and improving LPG prices. Overall, we expect GAIL's PAT to clock robust 29% CAGR over FY23-26E (which is one of best earnings growth among oil & gas PSUs) along with heathy RoE of 16%. GAIL's valuation is also attractive at 6.6x/5.9x FY25E/FY26E EV/EBITDA and the stock offers a healthy dividend yield of ~4-5%. Hence, we maintain our Buy rating on GAIL with an increased PT of Rs150.

- **Gas transmission – strong volume growth tailwinds:** Rising domestic gas supplies with higher domestic gas production (from RIL/ONGC) and ramp-up of new LNG terminals supported by affordable LNG price bodes well for sustained strong growth in GAIL's gas transmission volume (we model 9% CAGR over FY23-26E led by higher gas demand from CGD, fertilisers and petrochemicals). GAIL would benefit from the recent 33% hike in GAIL's transmission tariff to Rs58.61/mmbtu with the likelihood of further increase as GAIL submitted the approved tariff for review with PNGRB. Improved gas transmission volume outlook and better tariff bode well for robust recovery in gas transmission EBITDA over FY24E-26E.
- **Rise in crude oil and spot LNG price improves earnings outlook for downstream businesses and gas marketing:** The recent sharp rally in Brent crude oil price to ~$93-94/bbl and higher LPG price would drive recovery in GAIL's downstream businesses. Recent marginal improvement in international HDPE price to $1050/tonne (from June 2023 lows), higher petchem plant utilisation (now at 100% versus 50% in FY23) and softening of LNG price would drive a gradual turnaround in the petchem segment as compared to EBITDA loss of Rs508 crore in FY23. International LPG price has also recovered while GAIL's gas cost would remain capped over FY24-25 at $6.5/bbl, and thus its LPG-LHC segment could surprise positively with better profitability. Furthermore, the gap between JKM spot LNG and US LNG price has improved the competitiveness of GAIL's US LNG portfolio. The same bodes for sustained high profitability of GAIL's gas marketing business (management guidance of Rs3,500 EBITDA).
- **Strong earnings outlook over FY24-26:** We expect GAIL's earnings to witness a strong recovery over FY24-26 supported by an improving perspective across segments - gas transmission to benefit from higher tariff/volumes; petrochemical to turnaround on normalised plant utilisation, soft LNG price and gradual recovery in realisation while LPG-LHC margin to improve from APM gas price cap and recent improvement in LPG price. Management expects gas trading EBITDA of Rs. 3,500 crore for FY24. We have introduced our FY26 earnings estimate in this report and expect a robust EBITDA/PAT CAGR of 33%/29% over FY23-26E.

Our Call

Valuation – Maintain Buy on GAIL with a revised PT of Rs. 150: We expect GAIL to post strong earnings recovery across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Valuation of 6.6x/5.9x FY25E/FY26E EV/EBITDA is reasonable given a steep discount as compared to the historical average of 8.4x and expectation of a strong earnings recovery and a healthy dividend yield of ~4-5%. Hence, we maintain a Buy rating on GAIL with a revised PT of Rs. 150 (reflects rollover of valuation multiple to September 2025 earnings estimate).

Key Risks

1) LNG supply concerns and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilisation; 2) A sharp decline in LNG prices and international oil prices could impact profitability of gas trading, petrochemical, and LPG-LHC segments and 3) Sustained losses in petchem segment in case of volatility in HDPE and spot LNG prices.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	91,626	1,44,250	1,38,499	1,50,337	1,60,549
OPM (%)	15.1	4.6	8.6	9.2	9.8
Adjusted PAT	10,364	5,302	8,871	10,156	11,511
% YoY growth	111.9	-48.8	67.3	14.5	13.3
Adjusted EPS (Rs)	15.8	8.1	13.5	15.4	17.5
P/E (x)	7.7	15.1	9.0	7.9	6.9
P/B (x)	1.4	1.4	1.3	1.2	1.1
EV/EBITDA (x)	6.1	14.0	7.6	6.6	5.9
RoNW (%)	20.3	9.5	15.2	15.9	16.4
RoCE (%)	20.3	8.9	14.1	15.0	16.3

Source: Company; Sharekhan estimates

3R MATRIX

	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 29.23

Updated Aug 08, 2023

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

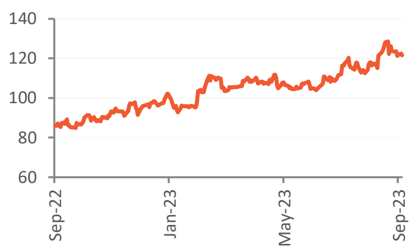
Company details

Market cap:	Rs. 79,920 cr
52-week high/low:	Rs. 130 / 83
NSE volume: (No of shares)	123.7 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	316.2 cr

Shareholding (%)

Promoters	51.9
FII	16.1
DII	18.1
Others	13.9

Price chart

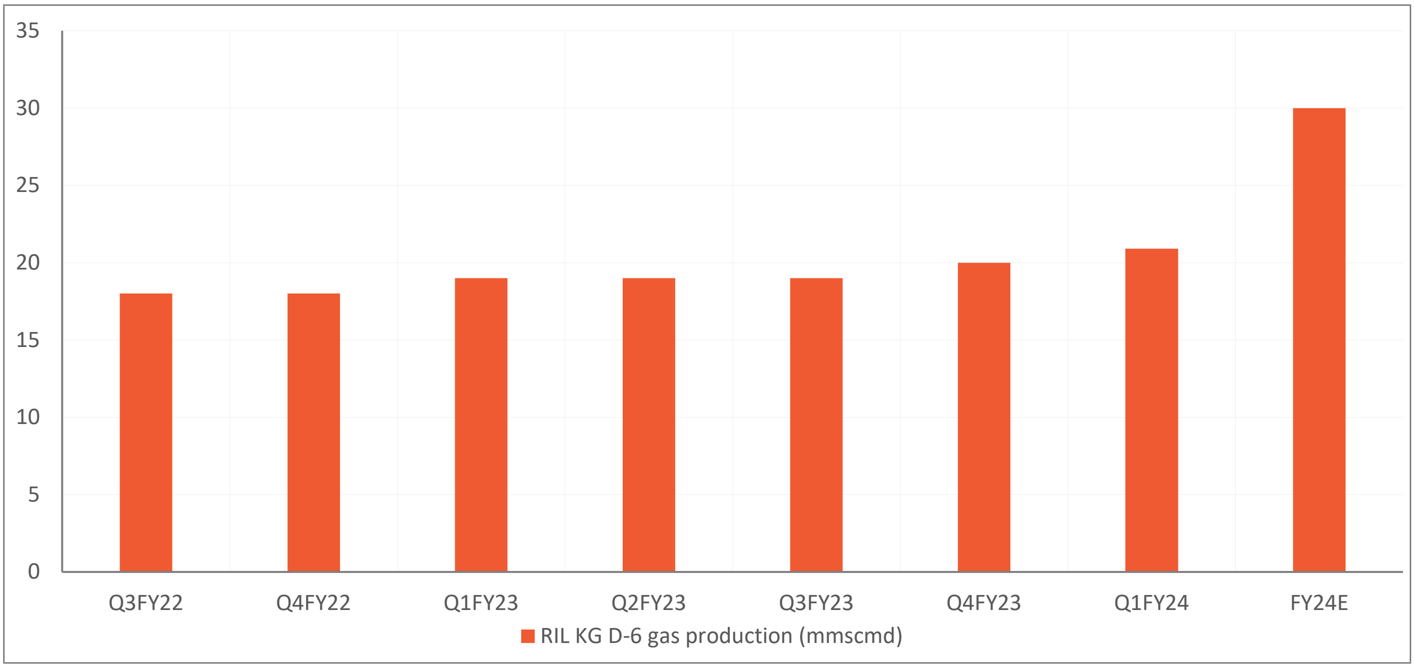


Price performance

(%)	1m	3m	6m	12m
Absolute	4.2	17.3	17.9	41.8
Relative to Sensex	2.6	13.2	3.4	26.2

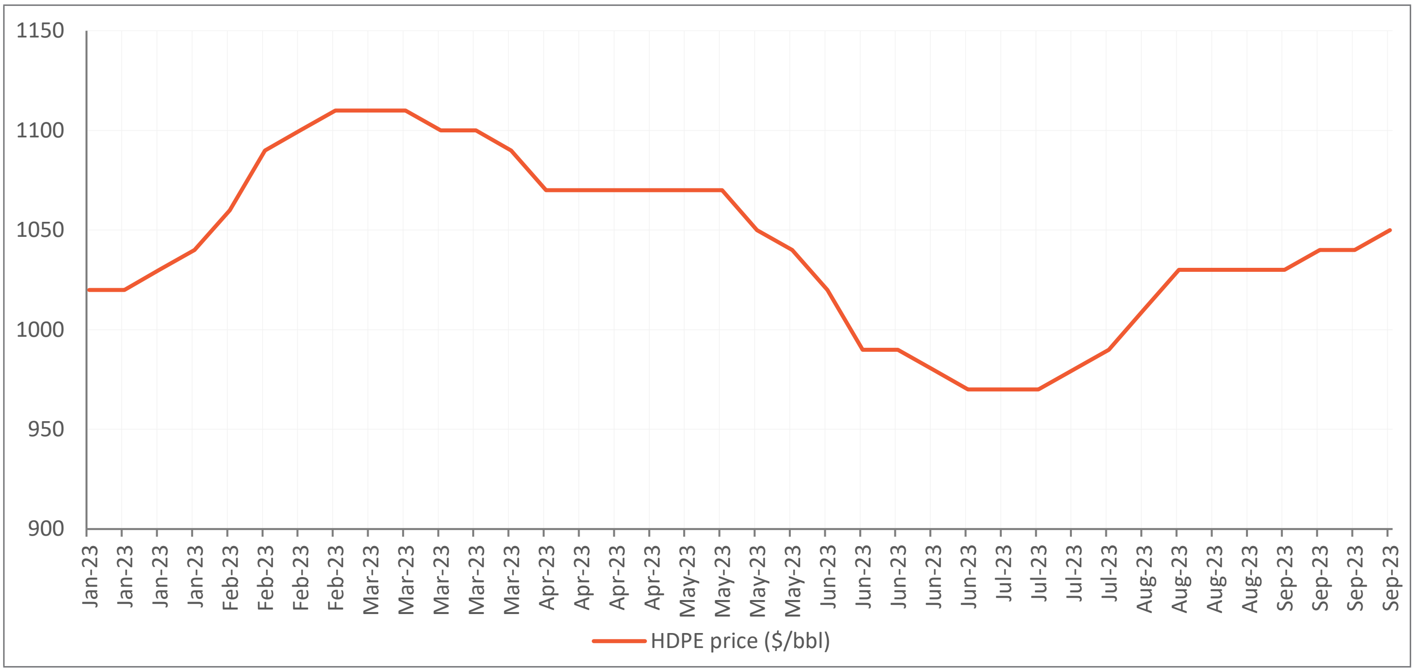
Sharekhan Research, Bloomberg

KG D-6 gas production to increase to 30 mmscmd in FY24



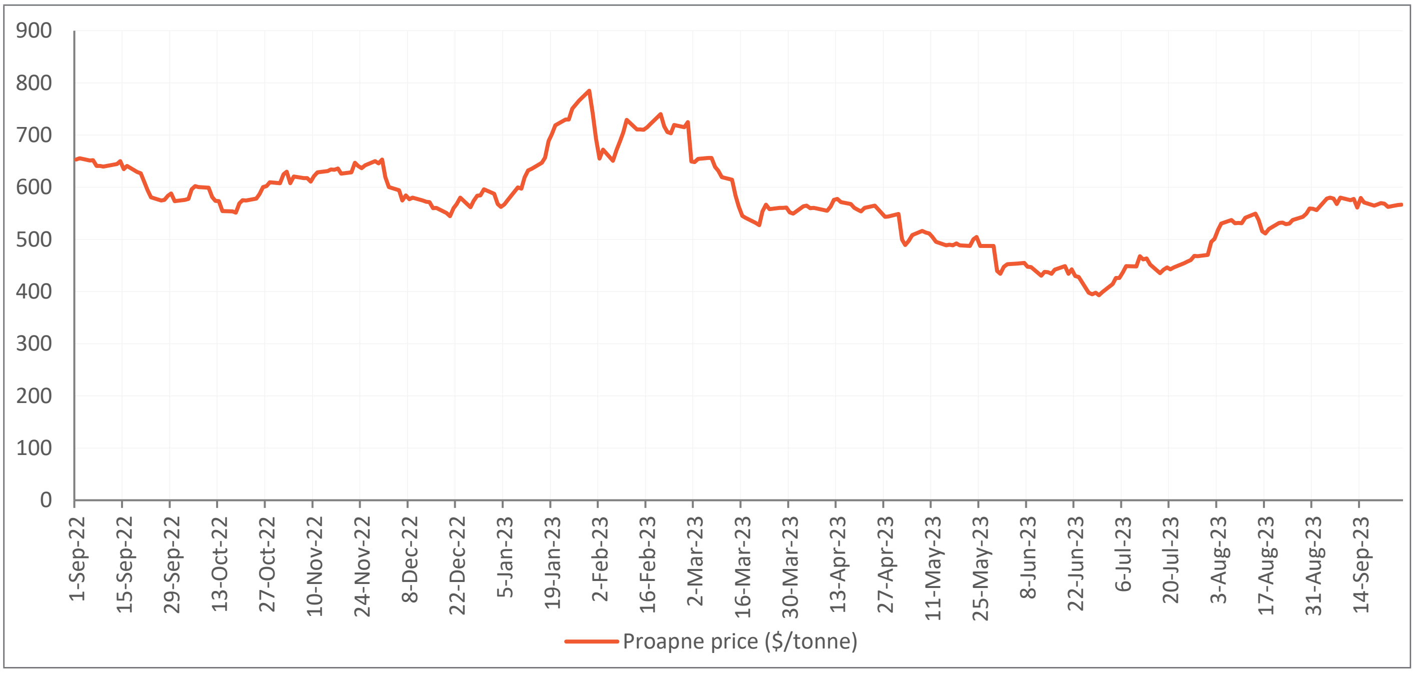
Source: RIL; Sharekhan Research

HDPE price increased marginally



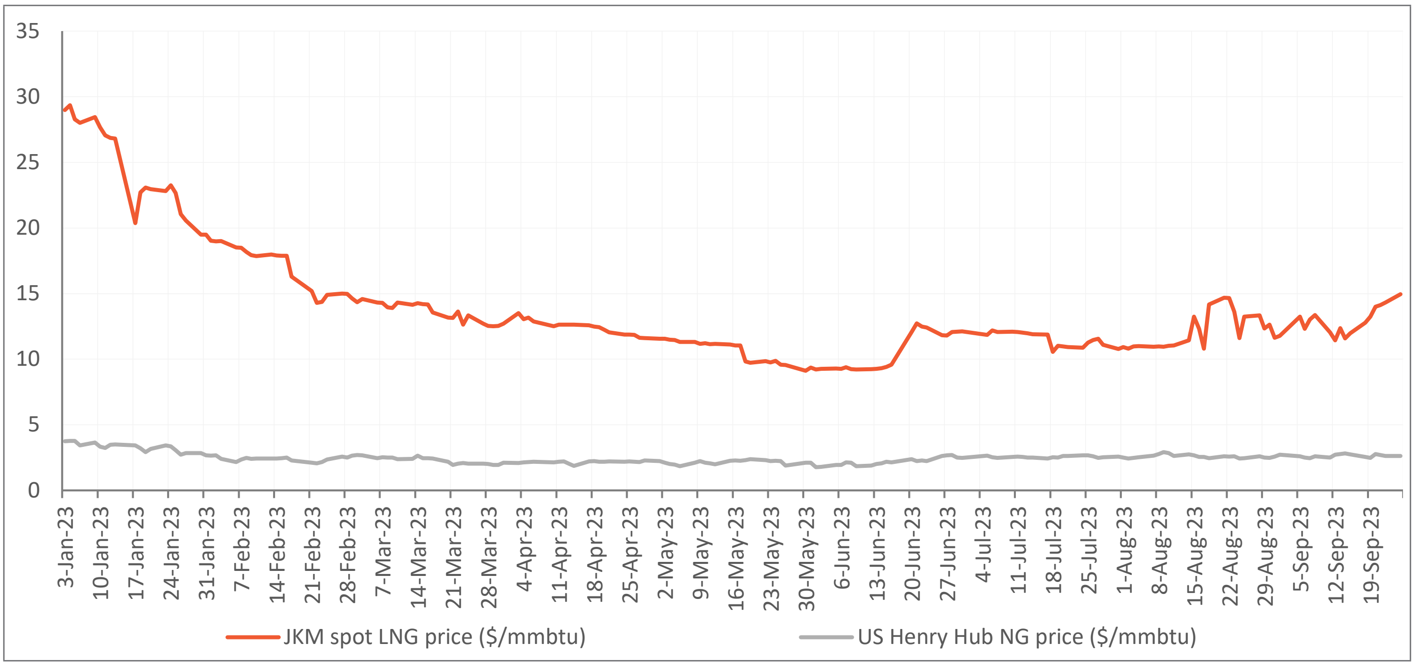
Source: Bloomberg; Sharekhan Research

Saudi Arabia propane prices have risen in last two months



Source: Bloomberg; Sharekhan Research

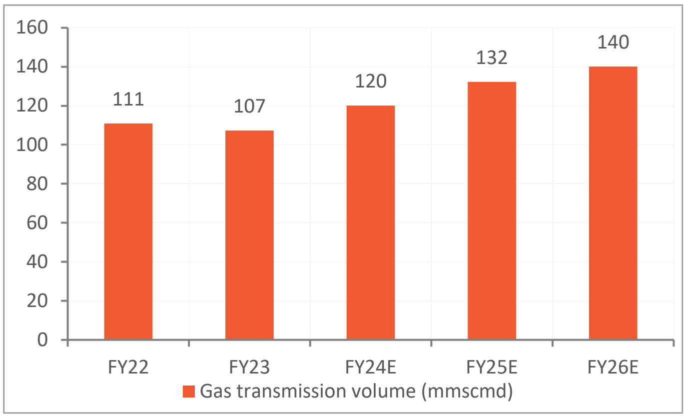
The price differential between Asian spot LNG price and US gas price to aid gas marketing margins



Source: Bloomberg; Industry reports; Sharekhan Research

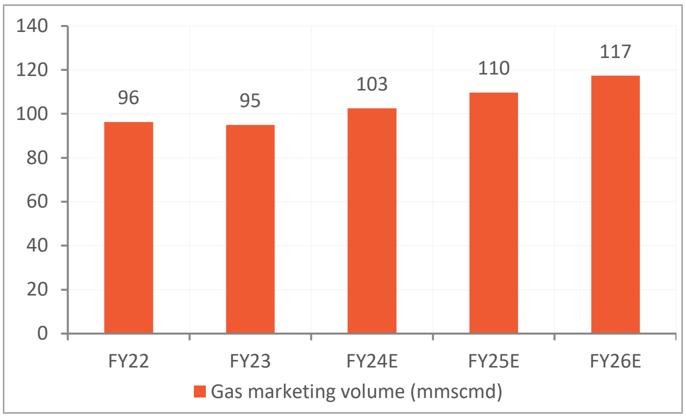
Financials in charts

Robust gas transmission volume growth outlook



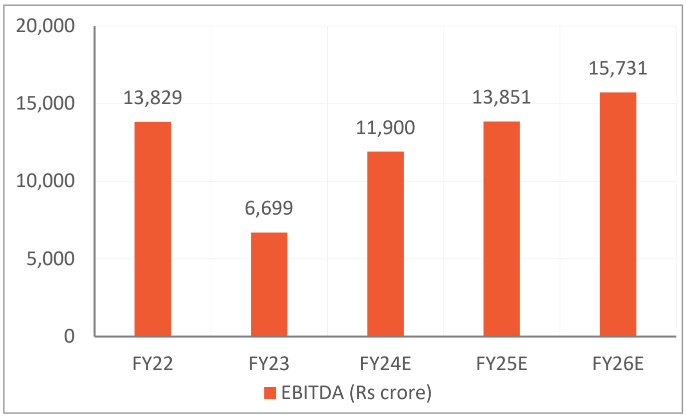
Source: Company, Sharekhan Research

Gas marketing volume to post 7% CAGR over FY23-26E



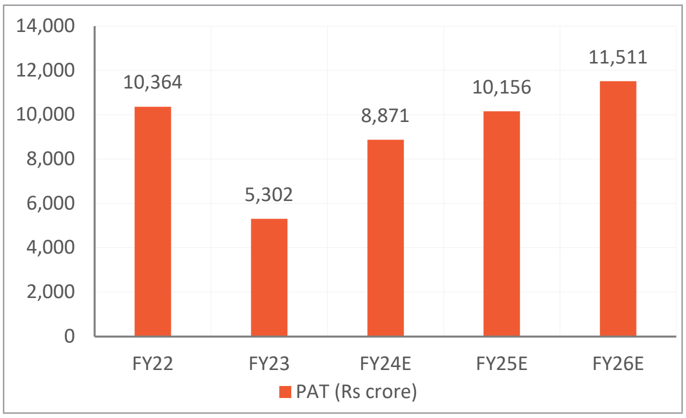
Source: Company, Sharekhan Research

EBITDA to clock 33% CAGR over FY23-26E



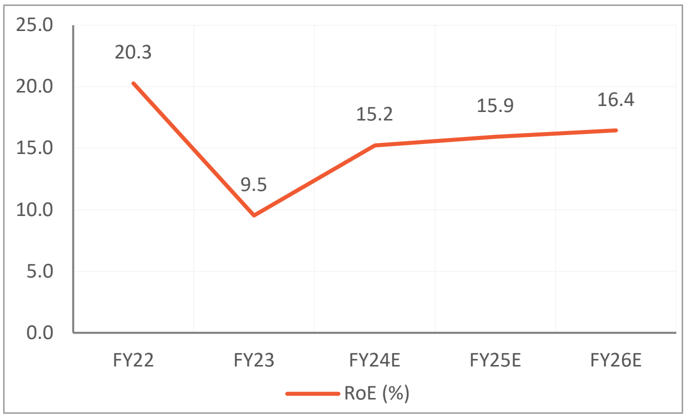
Source: Company, Sharekhan Research

PAT to clock 29% CAGR over FY23-26E



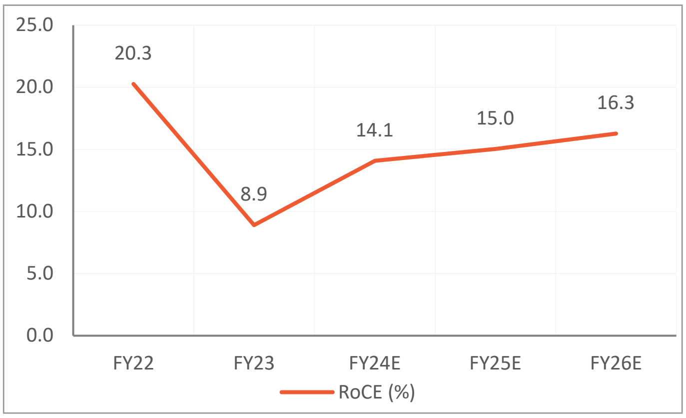
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View - Regulatory push to drive gas demand, volatile spot LNG/LPG/HDPE price a near-term concern

The long-term growth outlook for gas transmission volumes of gas utilities remains intact, supported by a robust gas demand outlook driven by 1) Higher demand from power, CGD, and fertiliser sectors and 2) Regulatory push for a shift to gas from polluting industrial/automobile fuels. In addition, the regulator's recent revision in gas pipeline tariff norms bodes well for higher transmission tariffs going forward. However, volatile spot LNG/LPG/HDPE price remains a key concern for the profitability of commodity business (like gas trading, petrochemical and LPG).

■ Company Outlook – Improving earnings outlook as gas supply concern eases

After a dismal show in FY23, we expect GAIL's earnings to witness a strong recovery in FY24, supported by an improving outlook across its business segments. Gas transmission would benefit from higher tariff/volume; petchem to turnaround on improved LNG supply and lower gas cost, while LPG-LHC margin to improve from the APM gas price cap. Management expects trading EBITDA of Rs. 3,500 crore annually. We expect GAIL's PAT to clock 29% CAGR over FY23-26E.

■ Valuation – Maintain Buy on GAIL with a revised PT of Rs. 150

We expect GAIL to post strong earnings recovery across its business segments supported by stabilising global LNG supplies and improving price environment for its commodity businesses. Valuation of 6.6x/5.9x FY25E/FY26E EV/EBITDA is reasonable given a steep discount as compared to the historical average of 8.4x and expectation of a strong earnings recovery and a healthy dividend yield of ~4-5%. Hence, we maintain a Buy rating on GAIL with a revised PT of Rs. 150 (reflects rollover of valuation multiple to September 2025 earnings estimate).

One-year forward EV/EBITDA (x) band

Source: Sharekhan Research

About company

GAIL is a dominant domestic gas utility company primarily engaged in gas transmission and marketing businesses. The company owns ~14,617 km of gas pipelines and markets two-thirds of gas sold in India. GAIL also owns and operates gas-based petrochemical plants with a capacity of 880 ktpa and LPG-LHC production facilities. The company also holds a substantial interest in the city gas distribution (CGD) businessstakes in CGD companies or through subsidiaries. GAIL also owns LNG import terminals.

Investment theme

Strong long-term gas demand supported by a favourable regulatory environment and improving gas supplies (through upcoming LNG terminals and higher domestic gas production) bode well for improvement in GAIL's gas transmission volumes in the next 2-3 years. We expect GAIL's earnings to witness a strong recovery in FY24, supported by an improving outlook across its business segments, given the normalisation of global LNG supply and prices. GAIL's valuation is attractive and the stock offers a healthy divided yield.

Key Risks

- Continued LNG supply concern and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilization,
- A sharp decline in LNG price and international oil prices could affect the profitability of gas trading, petrochemical, and LPG-LHC segments.
- Sustained losses in the petchem segment in case of volatility in spot LNG and HDPE price.

Additional Data

Key management personnel

Sandeep Kumar Gupta	Chairman and MD
Rakesh Kumar Jain	Director (Finance)
M.V. Iyer	Director (Business Developement)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.10
2	SBI Funds Management Ltd	2.32
3	Vanguard Group Inc/The	1.99
4	HDFC Asset Management Co Ltd	1.82
5	BlackRock Inc	1.14
6	Norges Bank	0.92
7	ICICI Prudential Asset Management	0.86
8	Dimensional Fund Advisors LP	0.63
9	FMR LLC	0.63
10	Franklin Resources Inc	0.62

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

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