

## Gazprom supply constraints to persist over the next 12 months

Rs97

We met the senior management of GAIL (CGM, F&A) on Dec 16, 2022 for an update on business and the outlook ahead. Key takeaways:

- ▶ **No resolution of Gazprom supply disruption:** Gazprom's gas supply to GAIL as a part of long term 2.4mtpa LNG contract was paused from May 2022 and has not been reinstated. GAIL has tried to mitigate this shortfall of 8-9mmscmd by cutting down supplies to fertiliser and power sectors and also reducing utilisation of its own Pata Petrochemical plant (in Uttar Pradesh) to <40%. There are still some customer contracts that it had to fulfill due to supply or pay obligation (to the extent of 1-1.5mmscmd) which it had done via spot LNG. Going forward, some additional volumes from domestic sources (RIL, ONGC, Cairn) will help improve overall transmission volumes. But for rest of FY23E and H1FY24E, the shortfall is likely to persist and hence, we see transmission volumes persisting between 108-109mmscmd in the near term.
- ▶ **Regulatory environment has improved:** In recent months, PNGRB has moved ahead on long-pending issues with respect to tariff and capex inclusions. A longer ramp-up for volumes (10 years vs 5 earlier), inclusion of 'system use gas' (SUG) @0.1%, 5-year exemption for capacity expansion from new gas sources and prospective tax rate will all be material positives for overall tariffs. Also, introduction of integrated tariffs will ease the pressure on customers at the farthest end of the network as they have to pay the cascading tariffs currently of all the pipelines that are used to transport the gas to them. On a blended basis, however, we see a material upside to transmission tariffs FY24E onwards.
- ▶ **Gas trading and petrochemical to remain under pressure:** Thanks to the disruption in Gazprom supply, GAIL is backstopping the supply gap by diverting all its cargoes to India. Resultant, it does not have any spare cargoes to leverage the spot LNG vs US HH differentials. Additionally, it has also cut the gas supply to its own petrochemical units at Pata and hence, utilisation of the same has reduced to ~40% and is likely to stay there for the next 6-9 months. The LPG segment remains relatively in good shape, and the imminent reduction of APM gas prices as per Kirit Parikh Committee should help ease margin pressures over FY24E.
- ▶ **We cut EPS for FY23/24e, BUY recommendation stays:** We revise FY23/24E EPS down by 10/9% respectively, to factor i) lower trading margins, ii) lower petrochemical volumes and iii) lower transmission volumes. This is offset partially by 5% higher transmission tariffs assumed for FY24e onwards, albeit there is an upside risk to this estimate. Valuations of <7x FY24E EPS and just 5.3x EV/EBITDA remain overly pessimistic and ignore the solid business model and strong long-term prospects. Reiterate BUY with a revised TP of Rs127 (earlier TP 137).

Company update and earnings revision

## Oil &amp; Gas and Petrochemicals

Target price: Rs127

## Earnings revision

(%)	FY23E	FY24E
Sales	↓ 2.8	↓ 0.6
EBITDA	↓ 11.0	↓ 9.5
EPS	↓ 10.2	↓ 9.2

## Target price revision

Rs127 from Rs137

## Shareholding pattern

	Mar '22	Jun '22	Sep '22
Promoters	51.8	51.9	51.9
Institutional investors	35.5	35.2	35.2
MFs and others	9.1	8.5	6.8
FIs/ Banks	0.1	0.1	0.1
Insurance	6.7	6.7	7.0
FII	19.6	19.9	21.3
Others	12.7	12.9	12.9

Source: www.nseindia.com

## ESG disclosure score

Year	2020	2021	Chg
ESG score	76.4	77.6	1.3
Environment	68.6	71.8	3.1
Social	69.3	69.9	0.6
Governance	91.1	91.1	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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Market Cap	Rs641bn/US\$7.8bn	Year to March	FY21	FY22	FY23E	FY24E
Reuters/Bloomberg	GAIL.BO/GAIL IN	Revenue (Rs mn)	5,74,283	9,27,698	10,70,656	10,55,199
Shares Outstanding (mn)	6575.1	Net Income (Rs mn)	60,595	1,23,037	82,365	1,01,369
52-week Range (Rs)	113 / 84	EPS (Rs)	9.2	18.7	12.5	15.4
Free Float (%)	41.1	% Chg YoY	-19%	103%	-33%	23%
FII (%)	21.3	P/E (x)	10.6	5.2	7.8	6.3
Daily Volume (US\$/'000)	16,718	CFPS (Rs)	10.0	19.6	13.3	16.5
Absolute Return 3m (%)	8.3	EV/E (x)	9.5	4.7	7.1	5.3
Absolute Return 12m (%)	21.3	Dividend Yield (%)	3%	6%	4%	5%
Sensex Return 3m (%)	4.7	RoCE (%)	7%	14%	7%	9%
Sensex Return 12m (%)	9.8	RoE (%)	8%	18%	9%	11%

**Table 1: Quarterly snapshot (standalone)**

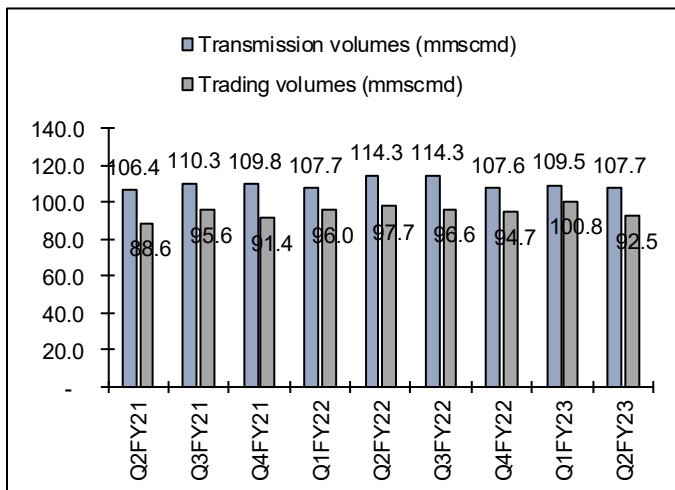
(Rs mn)	Q2FY23	Q2FY22	YoY% Chg	Q1FY23	QoQ% Chg	1HFY23	1HFY22	YoY% Chg
Net Sales	3,84,786	2,15,110	78.9	3,75,625	2.4	7,60,411	3,88,949	95.5
EBITDA	17,647	34,751	(49.2)	43,657	(59.6)	61,304	58,864	4.1
EBIT	11,453	29,507	(61.2)	37,627	(69.6)	49,081	48,534	1.1
Rep. PAT	15,371	28,630	(46.3)	29,152	(47.3)	44,523	43,929	1.4
Adj. PAT	15,371	28,630	(46.3)	29,152	(47.3)	44,523	43,929	1.4
Adj. EPS (Rs/sh)	2.3	4.4	(46.3)	4.4	(47.3)	6.8	6.7	1.4
<b>Volumes</b>								
NG transmission (mmscmd)	107.7	114.3	(5.8)	109.5	(1.6)	108.6	111.0	(2.2)
NG sales (mmscmd)	92.5	97.7	(5.3)	100.8	(8.2)	96.7	96.8	(0.1)
Petchem sales (kt)	108.0	221.0	(51.1)	109.0	(0.9)	217.0	359.0	(39.6)
LPG & liquid hydrocarbons (kt)	231.0	262.0	(11.8)	220.0	5.0	451.0	512.0	(11.9)
<b>Segment EBIT</b>								
Natural Gas transmission	7,096	10,400	(31.8)	8,005	(11.4)	15,101	19,549	(22.8)
LPG transmission	1,140	821	38.9	837	36.2	1,978	1,689	17.1
Natural Gas Trading	3,629	10,789	(66.4)	23,145	(84.3)	26,774	14,565	83.8
Petrochemicals	(3,462)	3,633		352		(3,111)	5,016	
LPG and Liquid Hydrocarbon	5,002	6,823	(26.7)	6,349	(21.2)	11,351	13,164	(13.8)
Others	1,437	975	47.3	1,526	(5.8)	2,962	1,662	78.3
<b>Total</b>	<b>14,842</b>	<b>33,442</b>	<b>(55.6)</b>	<b>40,213</b>	<b>(63.1)</b>	<b>55,055</b>	<b>55,645</b>	<b>(1.1)</b>

Source: Company data, I-Sec research

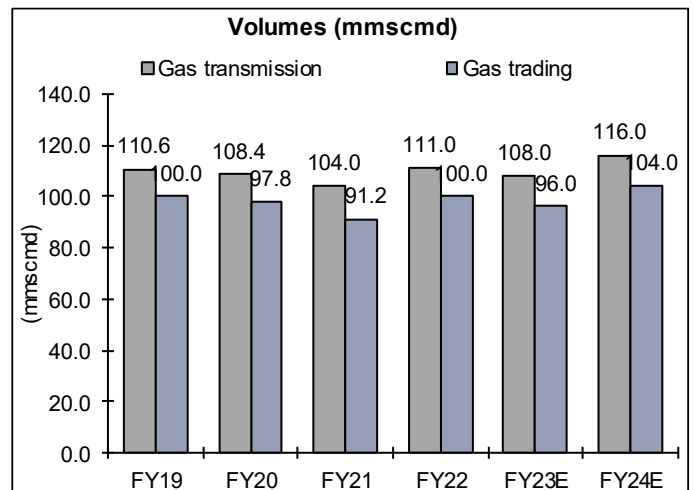
**Table 2: Change in earnings estimates: Lower transmission volumes and lower petrochemical & trading earnings drag numbers**

EBITDA (Rs mn)	New Estimates		Old Estimates		Change in estimates	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Gas Transmission	47,982	53,624	51,484	55,462	-7%	-3%
Gas Trading	35,728	41,731	44,248	50,105	-19%	-17%
LPG pipeline	4,265	4,587	4,265	4,587	0%	0%
LPG production	21,867	22,665	21,867	22,665	0%	0%
Petrochemicals	-2,931	9,458	-2,451	12,972	NA	-27%
<b>EBITDA Incl Other Income</b>	<b>1,06,910</b>	<b>1,32,065</b>	<b>1,19,413</b>	<b>1,45,791</b>	<b>-10%</b>	<b>-9%</b>
<b>EBITDA (Excl Other Income)</b>	<b>1,00,208</b>	<b>1,25,657</b>	<b>1,12,583</b>	<b>1,38,905</b>	<b>-11%</b>	<b>-10%</b>
<b>PAT</b>	<b>82,365</b>	<b>1,01,369</b>	<b>91,742</b>	<b>1,11,663</b>	<b>-10%</b>	<b>-9%</b>

Source: Company data, I-Sec research

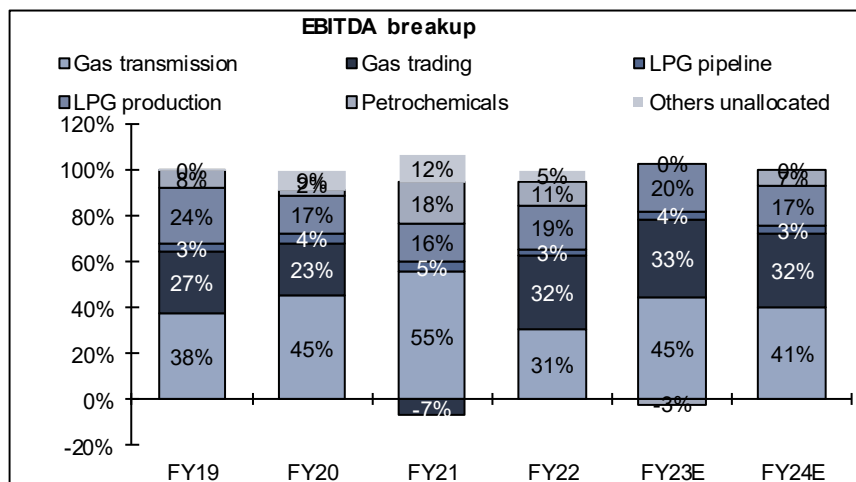
**Chart 1: Transmission volumes muted in Q2FY23**

Source: Company data, I-Sec research

**Chart 2: Expect 2-2.2% volume CAGR over FY22-FY24E**

Source: Company data, I-Sec research

Chart 3: Segmental EBITDA break up for FY19-24E



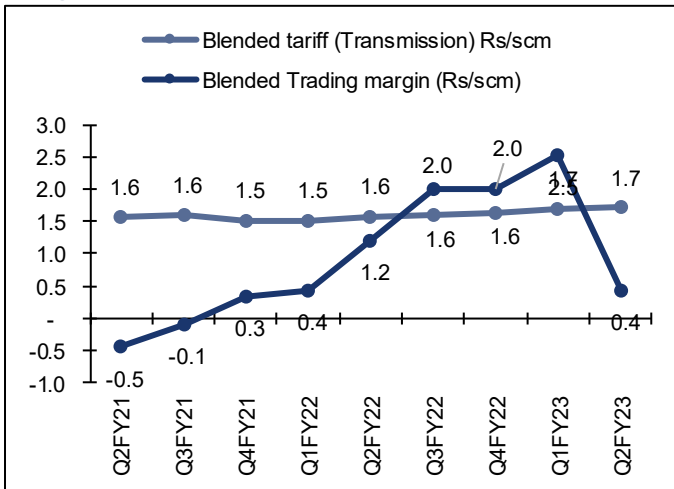
Source: Company data, I-Sec research

Table 3: GAIL tariff as on 1<sup>st</sup> Nov'22 (Rs/mmbtu) – varied tariffs across pipelines to be smoothened out over the next few years

Network/Region	Sub-Network	Total Capacity mmscmd	Zone 1	Zone 2	Zone 3	Zone 4
Agartala Network	NA	2.00	5.8	NA	NA	NA
Cauvery Basin	Narimanam - Kuthalam	2.00	43.8	NA	NA	NA
	Ramnad	2.33	9.6	NA	NA	NA
Chainsa-Jhajjar-Hisar	NA	35.00	7.9	NA	NA	NA
Dabhol-Bengaluru	NA	16.00	45.4	45.4	45.4	NA
Dadri-Bawana-Nangal	NA	31.00	14.0	14.1	NA	NA
Dahej-Uran-Dabhol-Panvel	NA	19.90	29.6	39.9	NA	NA
Dukli-Maharajganj	NA	0.08	27.4	NA	NA	NA
<b>Integrated HVJ</b>	<b>NA</b>	<b>107.00</b>	<b>19.8</b>	<b>36.9</b>	<b>45.4</b>	<b>49.6</b>
Jagdishpur-Haldia-Bokaro-Dhamra*	NA	7.44	63.4	63.5	NA	NA
Gujarat Regional P/L Network	South Gujarat Main	3.25	27.6	NA	NA	NA
	Motwan	0.09	2.8	NA	NA	NA
	Kadi-Kalol	0.13	61.6	NA	NA	NA
	Kalol-Ramol	0.67	1.9	NA	NA	NA
	Mehsana	0.24	14.8	NA	NA	NA
	Paliyad	0.07	4.6	NA	NA	NA
Ex-Hazira (GGCL)	3.88	1.1	NA	NA	NA	
KG- Basin	NA	16.00	16.1	NA	NA	NA
Kochi-Koottanad-Bengaluru-Mangaluru	NA	16.00	42.8	42.8	NA	NA
Mumbai Regional	Uran-Thal-Usar	3.54	6.0	NA	NA	NA
	Trombay	3.49	25.2	NA	NA	NA

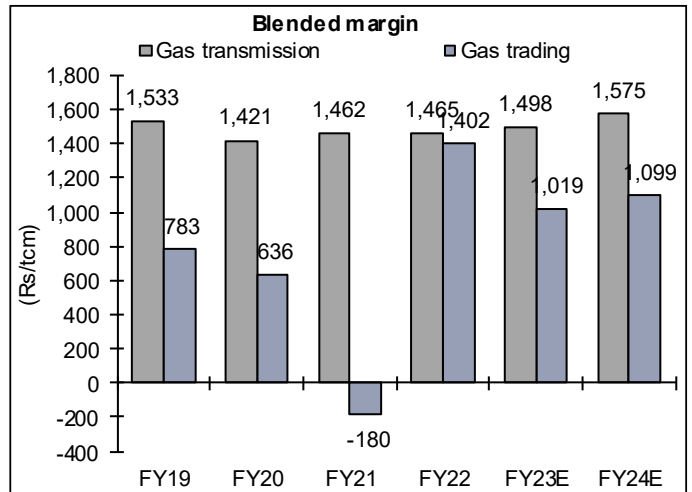
Source: Company data, I-Sec research \*Tariff for zone 3 &amp; 4 to be decided alongside completion of the Phase III &amp; IV of the pipeline

**Chart 4: In the last six quarters, blended transmission tariffs remained flat while trading margin was volatile**



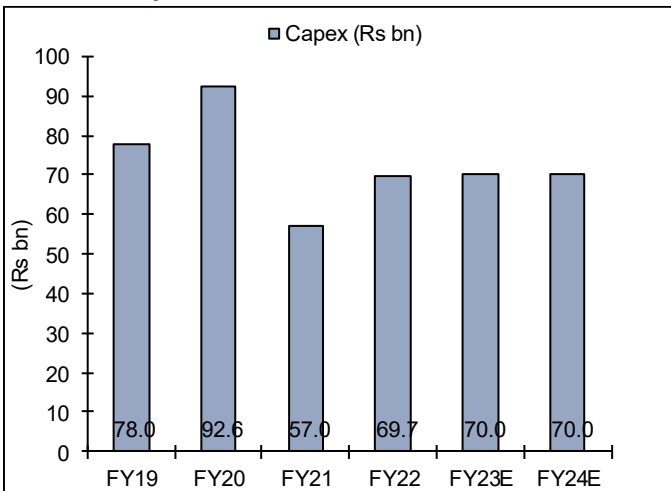
Source: Company data, I-Sec research

**Chart 5: We have factored in 5% increase in transmission tariffs for FY24E vs FY23E**



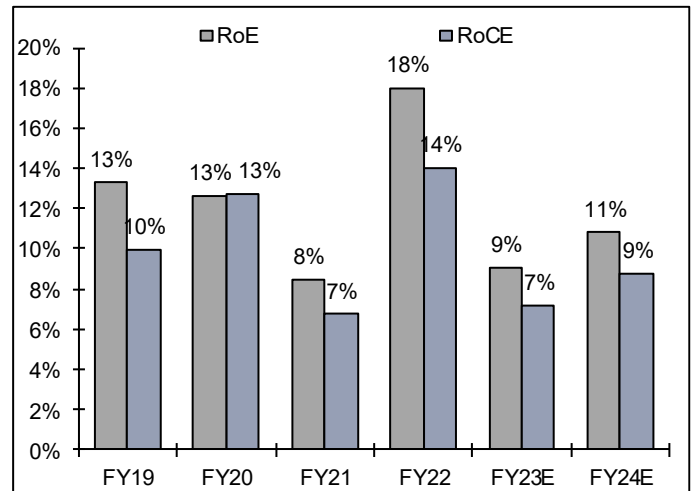
Source: Company data, I-Sec research

**Chart 6: Capex to remain material over FY23E-24E**

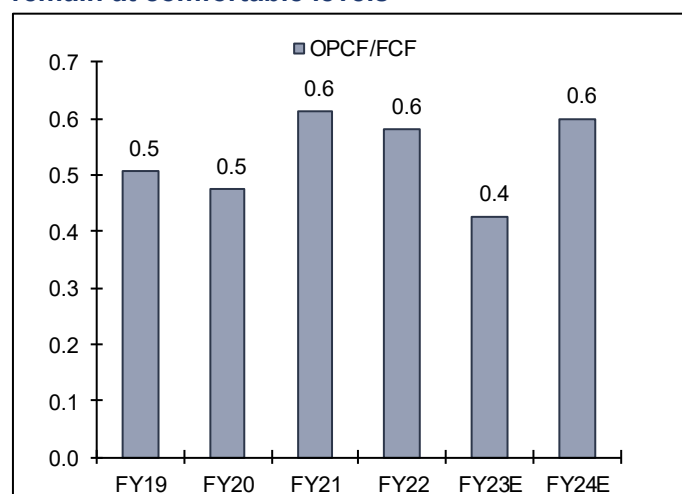


Source: Company data, I-Sec research

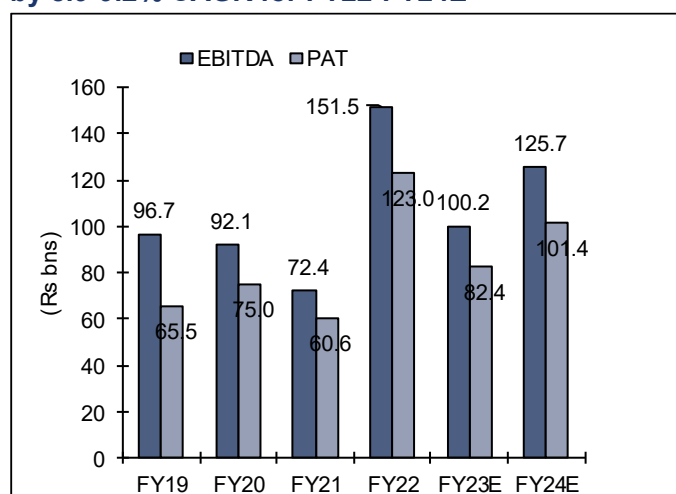
**Chart 7: Return ratios to moderate**



Source: Company data, I-Sec research

**Chart 8: Operating cashflow/free cashflow to remain at comfortable levels**

Source: Company data, I-Sec research

**Chart 9: EBITDA and net earnings growth to decline by 8.9-9.2% CAGR for FY22-FY24E**

Source: Company data, I-Sec research

**Table 4: GAIL expansion projects and overall capex for FY23-F26E**

Projects	Rs bns	Capacity
Mumbai Jharsugda	78	16mmscmd
Sirkakulam Angul	27	5-6mmscmd
Barauni Guwahati	33	5-6mmscmd
Dhamra – Haldia	10	
Petrochemical projects	100	
New Energy (electrolyser)	2.3	10MW
<b>Total</b>	<b>250.3</b>	

Source: Company data, I-Sec research

**Valuations: BUY, target price of Rs127/sh implies 30% upside**

We value GAIL on the basis of FY24E EV/EBITDA multiples of 4-5.5x applied to various segments, leading to a target price of Rs127/sh (implying 30% upside). Current valuations of 6.3x FY24E EPS and 5.3x FY24E EV/EBITDA remain well below 5-year valuation bands. Even at our target price, P/E of 8.2x FY24E EPS, and EV/EBITDA at 4.7x FY24E, are below peak valuations. Reiterate **BUY**.

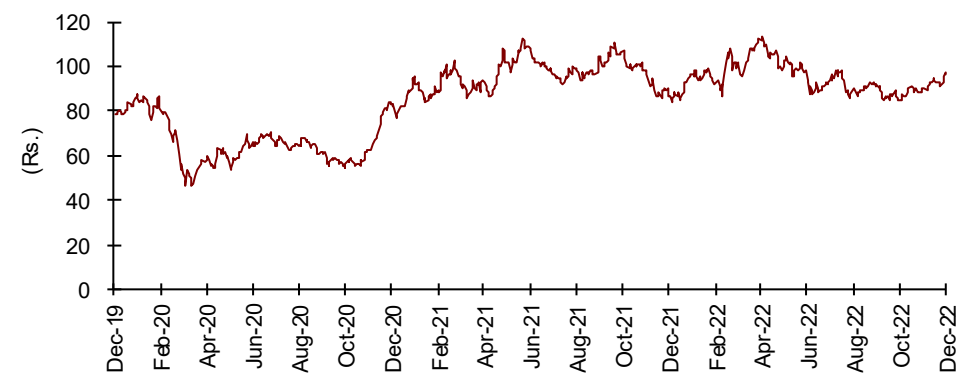
**Table 5: Valuation summary**

Business	Valuation measure used	Valuation		
		Rs bn	Rs/share	Break-up
Gas and LPG Transmission	DCF	260	40	30%
Gas Trading	EV/EBITDA (4.x FY24E)	169	26	20%
Petrochemicals	EV/EBITDA (5x FY24E)	47	7	5%
LPG & other hydrocarbon production	EV/EBITDA (5.5x FY24E)	125	19	14%
CGD entities other than IGL/MGL	17x FY24E	69	10	8%
Investments	Market value	194	29	22%
Less: Net debt		28	4	
<b>Total</b>		<b>835</b>	<b>127</b>	
<b>CMP</b>			<b>97</b>	
<b>Upside</b>			<b>30%</b>	

Source: I-Sec research

**Key Risks:** i) Sharper decline in transmission volumes even from current levels; ii) lower-than-expected price decline for petrochemical and LPG businesses; iii) lower gas consumption.

**Price chart**



Source: Bloomberg

## Financial summary

Table 6: Profit and loss statement

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
<b>Operating Income</b>				
(Sales)	5,74,283	9,27,698	10,70,656	10,55,199
<b>Operating Expenses</b>	5,01,845	7,76,182	9,70,448	9,29,541
<b>EBITDA</b>	72,438	1,51,516	1,00,208	1,25,657
% margins	13%	16%	9%	12%
Depreciation & Amortisation	21,738	24,202	25,972	27,535
Gross Interest	1,793	2,025	-696	-2,811
Other Income	10,434	11,723	6,702	6,408
<b>Recurring PBT</b>	60,109	1,37,012	81,634	1,07,341
Less: Taxes	15,826	31,599	20,409	26,835
<b>Net Income (Reported)</b>	60,595	1,23,037	82,365	1,01,369
<b>Recurring Net Income</b>	60,595	1,23,037	82,365	1,01,369

Source: Company data, I-Sec research

Table 7: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
<b>Assets</b>				
Total Current Assets	83,741	1,35,231	1,64,428	1,65,009
Total Current Liabilities & Provisions	1,10,294	1,41,624	1,42,950	1,49,415
<b>Net Current Assets</b>	-26,553	-6,393	21,478	15,593
<b>Investments</b>	1,64,262	2,01,898	2,01,898	2,01,898
<b>Net Fixed Assets</b>	5,45,600	6,00,625	6,44,653	6,87,118
Capital Work-in-Progress	1,33,997	1,54,904	1,54,904	1,54,904
<b>Total Assets</b>	7,03,555	8,24,170	8,66,515	9,20,880
<b>Liabilities</b>				
<b>Borrowings</b>	67,603	92,157	69,700	44,700
Equity Share Capital	44,404	44,404	44,404	44,404
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	4,87,417	5,96,936	6,61,540	7,40,706
<b>Net Worth</b>	5,31,823	6,41,343	7,05,946	7,85,113
<b>Total Liabilities</b>	7,03,555	8,24,170	8,66,515	9,20,880

Source: Company data, I-Sec research

Table 8: Quarterly trend

(Rs mn, year ending March 31)

	Dec-21	Mar-22	Jun-22	Sept-22
<b>Net sales</b>	2,57,698	2,69,619	3,75,625	3,84,786
% growth (YoY)	19.8%	4.6%	39.3%	2.4%
<b>EBITDA</b>	42,281	37,145	43,657	17,647
EBITDA Margin (%)	16.4%	13.8%	11.6%	4.6%
Other income	6,518	4,235	1,798	7,988
Add: Extraordinaries				
<b>Net profit</b>	32,880	26,831	29,152	15,371

Source: Company data, I-Sec research

Table 8: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
<b>Operating Cashflow before working capital changes</b>	78,744	1,64,613	1,00,208	1,25,657
Working Capital Changes	24,210	(35,485)	(27,871)	5,884
<b>Operating Cashflow</b>	89,934	96,286	52,128	1,04,905
Capital Commitments	(56,972)	(69,713)	(70,000)	(70,000)
Cashflow from Investing Activities	(46,403)	(56,995)	(42,159)	(42,730)
Inc (Dec) in Borrowings	5,749	6,258	(22,458)	(25,000)
Dividend paid	(22,381)	(39,954)	(17,762)	(22,202)
<b>Cashflow from Financing Activities</b>	(34,706)	(39,159)	(39,523)	(44,390)
<b>Chg. in Cash &amp; Bank balances</b>	8,825	132	(29,554)	17,785

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending March 31)

	FY21	FY22	FY23E	FY24E
<b>Per Share Data (Rs)</b>				
EPS(Basic Recurring)	9.2	18.7	12.5	15.4
Recurring Cash flow per share	12.5	22.4	16.5	19.6
Dividend per share (DPS)	3.4	6.1	4.0	5.0
Book Value per share (BV)	80.9	97.5	107.4	119.4
<b>Growth Ratios (%)</b>				
Operating Income	-21%	62%	15%	-1%
EBITDA	-21%	109%	-34%	25%
Recurring Net Income	-19%	103%	-33%	23%
Diluted Recurring EPS	-19%	103%	-33%	23%
<b>Valuation Ratios (x)</b>				
P/E	10.6	5.2	7.8	6.3
P/CFPS	9.7	5.0	7.3	5.9
P/BV	1.2	1.0	0.9	0.8
EV / EBITDA	9.5	4.7	7.1	5.3
EV/FCF	4.7	4.4	5.5	3.6
<b>Operating Ratios</b>				
Other Income / PBT (%)	17%	9%	8%	6%
Effective Tax Rate (%)	26%	25%	25%	25%
D/E Ratio (%)	13%	14%	10%	6%

**Return/Profitability Ratios (%)**

Recurring Net Income Margins	8%	11%	6%	8%
RoCE	7%	14%	7%	9%
RoNW	8%	18%	9%	11%
Dividend Payout Ratio	36%	32%	22%	22%
Dividend Yield	3%	6%	4%	5%
EBITDA Margins	13%	16%	9%	12%

Source: Company data, I-Sec research

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