

BSE Code: 532155
NSE Code: GAIL
Reuters Code: GAIL.NS
Bloomberg Code: GAIL:IN
Higher opex and one-offs weighed on Q4 performance...

GAIL (India) Limited is an integrated energy company in the hydrocarbon sector with presence across gas transmission, processing, distribution and marketing in India with a pipeline network of over 11,000 Kms.

Investment Rationale
Higher petchem production volumes boosts revenue in Q4FY17

State-owned gas utility GAIL Indian Ltd reported 11% QoQ (16% YoY) rise in net sales in Q4FY17 mainly contributed by growth in revenue across natural gas marketing, petrochemical and LPG & Hydrocarbons segment. While petchem volumes registered a growth of 27% QoQ driven by continued ramp-up of its petchem capacity at Pata, natural gas transmission/ trading volumes fell marginally by 1% each. Notably, LPG/LHC segment witnessed robust growth of ~20% QoQ aided by higher realisations (up ~28%). Total Opex increased by ~14% QoQ and YoY in Q4 mainly due to increase in employee cost on account of provisions made for increases in salary and gratuity.

Negative leverage hits EBITDA in Q4FY17

As a result, EBITDA of the company fell 10% QoQ to led by lower petchem realizations and higher employee costs. While, on YoY basis, EBITDA increased by 23%. The company's petrochemicals segment performance was below expectations in Q4FY17 with EBITDA down by 27% QoQ impacted by higher spot LNG prices, feedstock cost and lower realisations per tonne. Operating margin also contracted by 573bps QoQ to 3.8% in Q4 while total sales volume rose 27% QoQ. However, revenue increased by 25.7% QoQ to Rs1,766.37 crore due to 27% QoQ jump in sales volume. Meanwhile, the company's management has guided expanded petrochemical capacity utilisation at 90-100% in FY18 (86% in Q4FY17). Moreover, Gas transmission EBITDA fell 11% QoQ. While tariff remained flat QoQ at Rs1.16/scm in Q4, volumes fell marginally by 1% QoQ at 102mmscmd due to increase in natural gas prices. Natural gas marketing EBITDA stood at Rs449 crore (up 47% QoQ) mainly due to spurt in LNG price in January. However, LPG and other liquid hydrocarbon's EBITDA increased 34% QoQ (197% YoY) due to higher realisations. However, total sales volume fell 7% qoq to 276ktn.

Volume growth outlook remains healthy

We expect strong performance from petrochemicals segment to continue on account of higher capacity utilization and benefit of benign spot LNG prices (LNG prices have eased after January). The management expects capacity utilisation to rise to 90-100% in FY18 (86% in Q4FY17). Further, we expect LPG production to remain strong going ahead as increase in gas production from ONGC's Daman field would lead to increased availability of rich gas. Further, GAIL has outlined huge capex plans of Rs4,300cr/Rs7,700cr in FY18/FY19 which will be largely utilized in laying pipelines.

Valuations

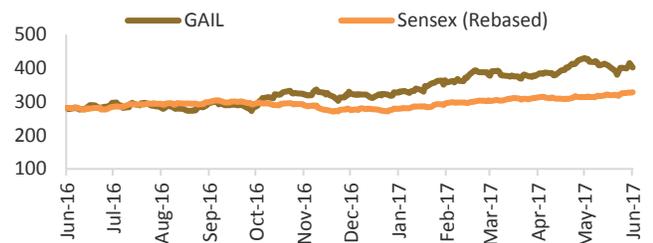
We expect revenue/PAT to grow at a CAGR of ~11%/18% over FY17-19E driven by higher utilisation levels in Petrochemicals segment coupled with strong transmission volumes. Further, concerns over the expensive long-term US LNG contracts is expected to ease with growth in domestic LNG demand especially from the fertiliser sector coupled with company's focus to sell more US LNG volumes to European and other consumers on long term basis and swap deals. The management expects a potential demand for ~3mmtpa from the commissioning of five fertiliser plants by end of CY20. Hence, we recommend a 'BUY' rating on the stock with a TP of Rs447 based on SOTP valuation methodology.

Market Data

Rating	BUY
CMP (Rs.)	402
Target (Rs.)	447
Potential Upside	11%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	433/269
Adj. all time High (Rs.)	433
Decline from 52WH (%)	7.2
Rise from 52WL (%)	49.4
Beta	0.7
Mkt. Cap (Rs.Cr)	68,041

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Revenue (Rs.Cr)	51,614	48,055	53,613	59,442
Adj. profit (Rs.Cr)	2,299	3,802	4,511	4,858
Adj. EPS (Rs.)	18.1	22.5	26.7	28.7
P/E (x)	22	18	15	14
P/BV (x)	1.7	1.8	1.7	1.6
ROE (%)	7.7	11.1	11.4	11.5

One year Price Chart

Shareholding Pattern

	Mar-17	Dec-16	Chg.
Promoters	54.97	56.57	(1.6)
FII's	15.26	14.99	0.27
MFs/Insti	24.48	25.54	(1.06)
Public	2.32	1.52	0.8
Others	2.97	1.38	1.59

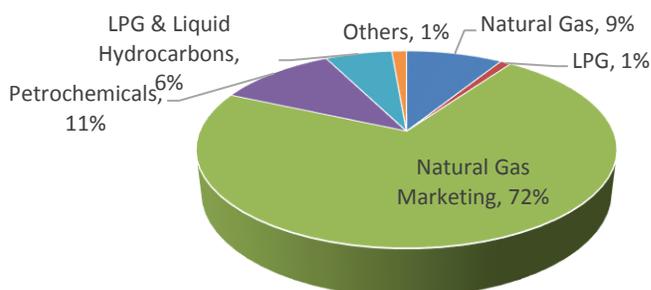
GAIL India Ltd: Business overview

Incorporated in 1984, GAIL (India) Limited is the largest public-sector natural gas company in India. It is an integrated energy company in the hydrocarbon sector with presence across gas transmission, processing, distribution and marketing. In addition, business of the company also spans across transmission of LPG, and production and marketing of Petrochemicals. Moreover, it has a strong pipeline network of about 11,000 km for natural gas and 2,038 km for LPG pipeline transmission. Besides, the company holds 71.2% domestic market share in gas marketing and 15% for petrochemicals. GAIL also has widespread operations in the international countries such as Singapore, China and USA.

Major segments of GAIL

The natural gas marketing segment contributes approximately 72% to the revenues of the company, followed by petrochemicals at 11% and the rest comes from other segments. The natural gas transmission segment has the highest EBITDA margin at 43%, followed by natural gas marketing segment at 21%.

Segment-wise revenue contribution (FY17)



Source: Company

Segmental Revenue

(Rs cr)	Q4FY17	Q4FY16	YoY		QoQ
			Growth %	Q3FY17	Growth %
Transmission Services					
Natural Gas	1,174	1,028	14.1	1,214	(3.3)
LPG	140	125	12.1	141	(0.6)
Natural Gas Marketing	10,371	9,204	12.7	9,414	10.2
Petrochemical	1,766	1,122	57.4	1,406	25.7
LPG & Liquid Hydrocarbons	989	761	29.9	826	19.7
Others	179	186	(3.8)	173	3.3

Higher petchem production boosts revenue

GAIL reported 11% QoQ (16% YoY) rise in net sales in Q4FY17 mainly contributed by growth in natural gas marketing (up 10.2%), petrochemical (up 25.7%) and LPG & Hydrocarbon (LPG/LHC) (up 19.7%) segments. While petchem volumes registered a growth of 27% QoQ driven by continued ramp-up of its petchem capacity at Pata, natural gas transmission/trading volumes fell marginally by 1% each. Notably, LPG/LHC segment witnessed robust growth of ~20% QoQ aided by higher realisations (up ~28%).

Sluggish operating performance in Q4FY17

EBITDA came in below street estimates & was down 10% QoQ primarily impacted by higher employee costs which rose 130 bps QoQ on account of higher provisions made for salary & gratuity. While natural gas transmission EBITDA fell ~11%QoQ owing to spurt in LNG price in January, gas marketing and LPG/LHC EBITDA rose ~47% and 34% QoQ respectively. Higher realisations in LPG/LHC led to the EBITDA beat. However, petchem EBITDA fell ~27% QoQ weighed down by higher feedstock cost and lower realisation per tonne. Despite decline in EBITDA, Adj. PAT rose 7% QoQ due to higher other income coupled with lower interest cost (down 86% QoQ). However, reported PAT fell 74% QoQ as the company took an impairment charge (due to accounting requirement) of Rs783cr with regards to an investment in Ratnagari Gas and Power Pvt Ltd which operates Dabhol power plant.

Quarterly Financials (Standalone)

(Rs cr)	Q4FY17	Q4FY16	YoY Growth %	Q3FY17	QoQ Growth %
Sales	13,452	11,660	15.4	12,132	10.9
EBITDA	1,555	1,265	23.0	1,726	(9.9)
Margin (%)	11.6	10.8	72bps	14.2	(266)bps
Depreciation	347	343	1.2	358	(3.0)
EBIT	1,208	922	31.1	1,368	(11.7)
Interest	22	153	(85.6)	160	(86.3)
Other Income	468	220	113.1	276	69.7
Exceptional Items	(788)	-	-	-	-
PBT	866	988	(12.4)	1,484	(41.6)
Tax	606	156	288.1	501	21.0
PAT	260	832	(68.7)	983	(73.5)
Minority Interest/ PL from Associates	-	-	-	-	-
Reported PAT	260	832	(68.7)	983	(73.5)
Adjustment	788	-	-	-	-
Adj PAT	1,048	832	26.0	983	6.6
No. of shares (cr)	1,691.3	1,268.5	33.3	1,268.5	33.3
EPS (Rs)	6.2	6.6	(5.5)	7.7	(20.0)

Source: Company, In-house research

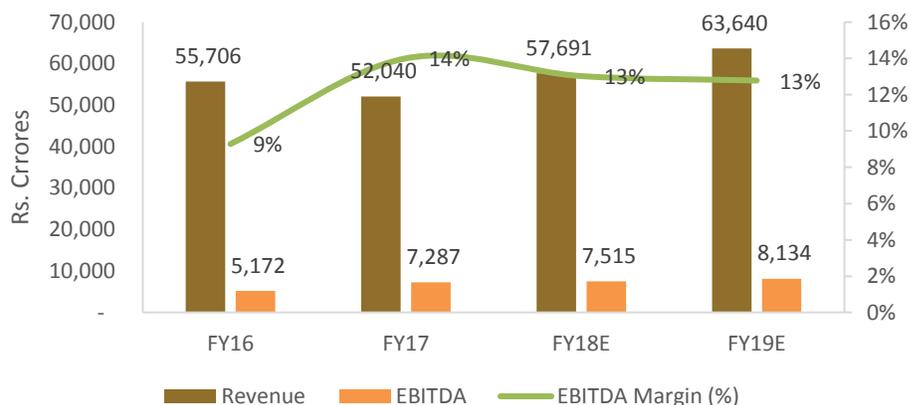
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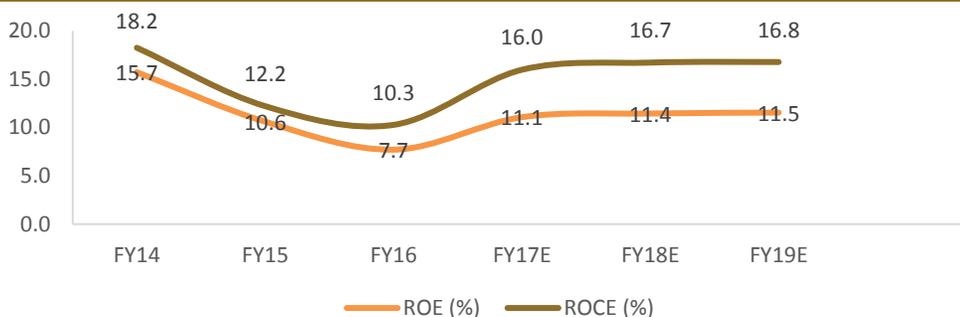
EBITDA margin to expand by 70bps over FY17-19E

We expect revenue/EBITDA to grow at a CAGR of 11.2%/13.7% over FY17-19E driven by higher utilisation levels in Petrochemicals segment coupled with strong transmission volumes and benign gas prices.

EBITDA to grow at 11% CAGR over FY17-19E



Return ratios trend



Source: Company, In-house research

Key Risks:

- Volatility in prices of crude oil.
- Any reduction if tariff reduction in existing pipelines
- Price differential on its US LNG contracts and global polymer demand-supply situation

Sum-of-the-parts Valuation

	Basis	Multiple (x)	Value (Rscr)	Value/share (Rs)
Core business	Mar-19 EV/EBITDA	7.5	60,050	355
Less: Net debt			3,519	21
Listed Investments	20% Holdco Disc.		12,700	75
Unlisted Investments			6,402	38
Total Valuation			75,633	447

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Total operating Income	51,614	48,055	53,613	59,442
Raw Material cost	42,195	36,393	40,257	44,812
Employee cost	996	1,258	1,662	1,843
Other operating expenses	4,455	4,089	4,169	4,622
EBITDA	3,968	6,315	7,525	8,165
Depreciation	1,313	1,397	1,449	1,541
EBIT	2,655	4,918	6,077	6,624
Interest cost	640	479	315	392
Other Income	1,158	1,271	1,013	1,064
Profit before tax	3,173	5,710	6,775	7,297
Tax	874	1,908	2,264	2,438
Profit after tax	2,299	3,802	4,511	4,858
Minority Interests	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	2,299	3,802	4,511	4,858
E/o income / (Expense)	-	299	-	-
Reported PAT	2,299	4,100	4,511	4,858

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Paid up capital	1,268	1,691	1,691	1,691
Reserves and Surplus	29,316	36,458	39,029	41,851
Net worth	30,585	38,149	40,720	43,542
Minority Interest	-	-	-	-
Total Debt	5,781	3,005	3,005	4,455
Other non-current liabilities	1,699	2,085	2,085	2,085
Total liabilities	38,065	43,239	45,810	50,082
Net fixed assets	28,746	28,506	29,161	31,320
Capital WIP	3,403	3,803	5,200	7,500
Goodwill	-	-	-	-
Investments	4,547	9,510	9,510	9,510
Total Net Current Assets	(139)	770	1,289	1,102
Deferred tax assets (Net)	(4,047)	(4,656)	(4,656)	(4,656)
Other non-current assets	5,555	5,306	5,306	5,306
Total assets	38,065	43,239	45,810	50,082

Cash Flow Statement (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Pre tax profit	3,173	5,411	6,775	7,297
Depreciation	1,314	1,397	1,449	1,541
Chg in Working Capital	616	(725)	(371)	(368)
Others	436	(791)	(698)	(673)
Tax paid	(704)	(1,335)	(2,264)	(2,438)
Cash flow from operating activities	4,835	3,957	4,890	5,359
Capital expenditure	(1,496)	(1,557)	(3,500)	(6,000)
Chg in investments	(224)	(4,963)	-	-
Other investing cashflow	709	1,271	1,013	1,064
Cash flow from investing activities	(1,011)	(5,250)	(2,487)	(4,936)
Equity raised/(repaid)	-	(0)	-	-
Debt raised/(repaid)	(1,634)	(2,777)	-	1,450
Dividend paid	(840)	(1,842)	(1,940)	(2,037)
Other financing activities	(697)	5,460	(315)	(392)
Cash flow from financing activities	(3,171)	841	(2,255)	(978)
Net chg in cash	652	(452)	149	(555)

Key Ratios (Standalone)

Y/E	FY16	FY17	FY18E	FY19E
P/E	22.2	17.9	15.1	14.0
EV/EBITDA	13.9	11.0	9.2	8.8
EV/Net Sales	1.1	1.5	1.3	1.2
P/B	1.7	1.8	1.7	1.6
Per share data				
EPS	18.1	22.5	26.7	28.7
DPS	5.5	9.1	9.5	10.0
BVPS	241.1	225.6	240.8	257.4
Growth (%)				
Net Sales	-8.8	-6.9	11.6	10.9
EBITDA	-12.3	59.1	19.2	8.5
Net profit	-22.8	65.4	18.7	7.7
Operating Ratios				
EBITDA Margin (%)	7.7	13.1	14.0	13.7
EBIT Margin (%)	5.1	10.2	11.3	11.1
PAT Margin (%)	4.5	7.9	8.4	8.2
Return Ratios (%)				
RoE	7.7	11.1	11.4	11.5
RoCE	10.3	16.0	16.7	16.8
Turnover Ratios (x)				
Net Sales/GFA	1.2	1.1	1.2	1.2
Sales/Total Assets	1.0	0.9	0.9	1.0

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* GAIL is a large-cap company.

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