

BSE SENSEX
33,600

S&P CNX
10,441

CMP: INR465

TP: INR376 (-19%)

Sell



Stock Info

	GAIL IN
Bloomberg	GAIL IN
Equity Shares (m)	1,691
52-Week Range (INR)	480 / 301
1, 6, 12 Rel. Per (%)	4/-/24
M.Cap. (INR b)	791.7
M.Cap. (USD b)	12.3
Avg Val, INRm	1490
Free float (%)	45.6

Financials Snapshot (INR b)

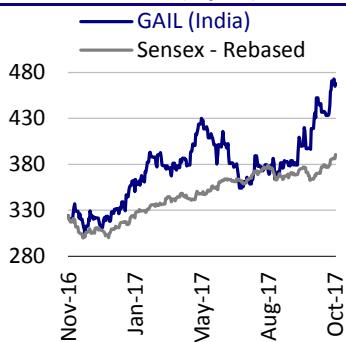
Y/E Mar	2018E	2019E	2020E
Net Sales	525.3	607.6	653.6
EBITDA	77.6	88.2	93.2
PAT	45.4	53.1	56.6
EPS (INR)	26.8	31.4	33.5
Gr. (%)	18.8	17.2	6.6
BV/Sh (INR)	242.3	261.8	282.7
RoE (%)	11.5	12.5	12.3
RoCE (%)	9.8	10.7	10.5
P/E (x)	17.5	14.9	14.0
P/BV (x)	1.9	1.8	1.7
EV/EBITDA (x)	9.8	8.6	8.1

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	54.4	54.4	56.1
DII	24.3	24.9	25.2
FII	16.5	16.0	15.9
Others	4.8	4.6	2.8

FII Includes depository receipts

Stock Performance (1-year)



Making room for higher crude oil price

Remain concerned on US contracts; higher tariffs pose upside risk

- Since our [last update](#), Brent has jumped to ~USD60/bbl. Higher Brent would help both petchem and LPG segments.
- In this update, we factor in higher Brent and changes in valuation of investments, and roll over our target price to September 2018E.
- Our concern on profitable placement of US contracts remains. While our target price is revised from INR334 to INR376, we maintain our Sell rating. Nevertheless, we also highlight the upside risk due to unified tariffs.

Higher crude oil helps in better petrochemical/LPG profitability

- We estimate that at full utilization, a USD5/bbl rise in Brent would increase GAIL's petchem EBITDA by 11%. LPG/HCs segment would add another ~17%.
- As a result of change in our crude oil assumption from USD55/bbl to USD60/bbl for FY19, we increase our EBITDA estimate from INR87b to INR88b.

Unified tariffs could be a risk

- GAIL has asked for unified tariff of INR57/mmBtu to take care of lower capacity utilization, to improve RoE, and to ensure lower tariffs for new pipelines like Jagdishpur-Haldia-Bokaro-Dhamra.
- We estimate that this could increase EBITDA by INR21.5b or ~24%, and could translate to 27% of FY19E EPS.

Remain concerned on US contracts

- The company seems to have placed significant part of its volume for 2018. However, GAIL is tied up with long term contract while these are only short term measures and would hog unless long term structural solution is found.
- A hit of USD1/mmBtu on the whole quantity could wipe out ~22% of its EBITDA. We do not see much room for negotiation in these contracts. However, any successful resolution could benefit the company immensely.

Valuation and recommendation

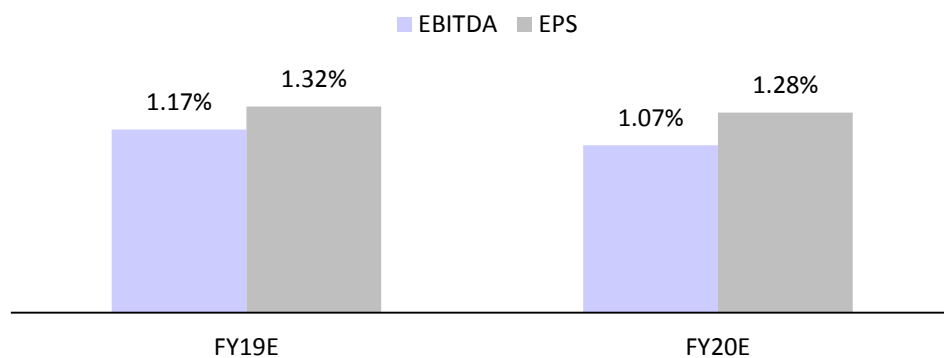
- Post our report in June 2017, the stock has outperformed the Nifty by ~8% on expectation of resolution of US contracts as well as benefit from unified tariff.
- The stock is trading at 14.8x FY19E EPS and at an EV of 8.6x FY19E EBITDA. We value it at 9x average FY19-20E EPS adjusted for other income, and then add the value of investments.
- As a result of revised value of investments, increase in crude oil assumption and rolling our valuation to September 2018E, our target price is raised from INR334 to INR376. However, we maintain our **Sell** rating.

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Motilal Oswal research is available on www.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Exhibit 1: USD1/bbl increase in Brent price benefits EBITDA/EPS

Source: MOSL, Company

Exhibit 2: Unified tariff could boost profitability

	Volume in FY17 (mmscmd)	Existing tariff (INR/mmBtu)	Proposed tariff (INR/mmBtu)	Impact on EBITDA (INRm)
DBNPL	4.65	73.36	57	(1,102)
CJHPL	0.97	67.17	57	(143)
DBPL	1.17	40.83	57	274
DUPL-DPPL	12.62	24.49	57	5,942
HVJ-GREP-DVPL	33.16	25.46	57	15,148
DVPL/GREP upgradation	28.26	53.65	57	1,371
Total				21,491
Tax rate (%)				33.33
Impact on PAT (INR mn)				14,328
Impact on EPS				8.5
EPS FY19E (INR)				31.3
Increase (%)				27.1

Source: MOSL, Company

Valuation and view

Maintain Sell

- Led largely by the petrochemicals and LPG segments, we expect EBITDA to grow 37% in FY18. Gas transmission and LPG would further support 10% increase in EBITDA in FY19. EPS is likely to grow 19% in FY18 and 17% in FY19.
- However, RoE at 12.5% and RoCE at 10.7% for FY19 would still remain 5% lower than a decade ago, due to increased balance sheet size.
- Threat of losses on US shale gas import contracts looms large and may wipe out ~20% of EBITDA for each USD1/mmBtu loss. In the current pricing environment, US shale would be ~USD2/mmBtu higher than prevailing spot prices in the Asia-Pacific.
- We value GAIL using SOTP at INR376/share, implying ~19% downside. The core business is valued at 9x FY19E EPS adjusted for other income. We add another INR100 for listed and unlisted investments. Reiterate **Sell**.

Exhibit 3: Key assumptions

	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Brent crude (USD/bbl)	114.5	110.0	107.8	86.0	47.5	49.0	55.4	60.0	60.0
Exchange Rate (INR/USD)	47.9	54.5	60.6	61.1	65.5	67.1	64.6	66.1	67.0
Subsidy (INRb)	31.8	26.9	19.0	10.0	-	-	-	-	-
Avg. Gas Price (USD/mmbtu)	5.7	6.7	7.9	8.4	7.6	5.8	6.3	6.6	6.7
Natural Gas Transmission									
Total (mmscmd)	119	105	97	93	93	100	106	113	121
Adj. Average Tariff (INR/mscm)	887	883	1,169	987	1,107	1,257	1,263	1,344	1,396
LPG Transmission									
Volume ('000 MT)	3,362	3,200	3,030	3,094	2,819	3,363	3,615	3,615	3,615
Average Tariff (INR/MT)	1,351	937	1,329	1,424	1,724	1,530	1,530	1,530	1,530
Petrochemicals									
Capacity ('000 MT)	450	450	450	450	900	900	900	900	900
Utilization (%)	100%	95%	100%	98%	37%	64%	75%	95%	100%
Sales ('000 MT)	448	427	445	441	334	578	675	855	900
Realization (USD/MT)	1,589	1,614	1,703	1,801	1,420	1,468	1,440	1,437	1,437
LPG & liq. HC									
Sales ('000 MT)	1,439	1,371	1,308	1,279	1,087	1,095	1,100	1,100	1,100
LPG realization (USD/MT)	910	957	936	784	468	435	492	532	532
EPS (INR/sh)	21.6	23.8	24.4	17.7	13.2	22.6	26.8	31.4	33.5

Source: Company, MOSL

Exhibit 4: Segmental EBITDA breakdown (INR b)

Segmental EBITDA (INRb)	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
NG transmission	26.3	24.7	27.7	21.4	26.2	31.4	33.8	38.7	42.8
Gas trading	10.9	13.9	16.0	6.9	14.7	9.7	10.8	11.8	12.7
LPG transmission	3.2	1.5	2.6	2.9	3.1	3.1	3.5	3.0	2.9
Petrochemicals	16.4	17.1	15.5	2.2	-4.3	8.9	15.6	19.7	20.5
LPG (pre-subsidy)	38.3	43.6	30.1	29.8	8.0	12.9	17.7	19.9	19.7
Others	-0.9	-1.6	6.5	3.0	3.5	1.4	4.9	4.9	4.9
Sub-total	94.3	99.2	98.5	66.2	51.3	67.3	86.4	98.1	103.4
Subsidy	(31.8)	(26.9)	(19.0)	(10.0)	0.0	0.0	0.0	0.0	0.0
Total	62.5	72.3	79.5	56.2	51.3	67.3	86.4	98.1	103.4

Source: Company, MOSL

Exhibit 5: SOTP-based target price stands at INR376/share

Business	INR/sh	Remarks
PE Multiple (x)	9x	
FY19-20 adj. EPS	30.7	9x FY19-20E adj. EPS
Core Business	276	
Listed Investments	85	30% discount to CMP/target price
Unlisted investments	15	30% discount to book value
Target price	376	

Source: MOSL, Company

Exhibit 6: Our 9x multiple is at a ~35% premium to the fundamental forward P/E of 7x

$Forward\ PE = \frac{P_0}{EPS_1} = \frac{1 - \frac{g_n}{RoE_n}}{k_e - g_n}$ <ul style="list-style-type: none"> - P_0 = Price per share in year 0 - EPS_1 = Earnings per share in year 1 - g_n = Stable growth rate for n years - RoE_n = Stable return on equity for n years - k_e = Cost of equity (expected market returns) 	$Forward\ PE = \frac{1 - \frac{5\%}{15\%}}{15\% - 5\%} = 6.7x$ <ul style="list-style-type: none"> - We expect GAIL to grow at 5%, lower than the GDP growth rate of 7%. - Expect its RoE to remain in a range of 14-15%. - Expect 15% equity market returns
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Source: MOSL, Company

Exhibit 7: Sensitivity to Petchem EBITDA

FY19E	Crude (USD/bbl)			
	50	55	60	65
INR million	50	55	60	65
Petchem EBITDA	15,555	17,637	19,720	21,803
% change vs base case	-21%	-11%	0%	11%
Total EBITDA	77,870	83,036	88,203	93,370
% change vs base case	-12%	-6%	0%	6%
EPS (INR)	27.28	29.35	31.42	33.49
% change vs base case	-13%	-7%	0%	7%

Source: Company, MOSL

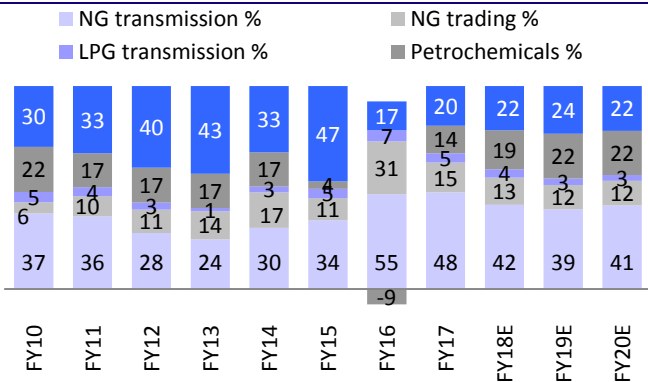
Exhibit 8: Sensitivity to LPG EBITDA

FY19E	Crude (USD/bbl)			
	50	55	60	65
INR million	50	55	60	65
LPG EBITDA	13,475	16,702	19,928	23,154
% change vs base case	-32%	-16%	0%	16%
Total EBITDA	77,870	83,036	88,203	93,370
% change vs base case	-12%	-6%	0%	6%
EPS (INR)	27.28	29.35	31.419	33.49
% change vs base case	-13%	-7%	0%	7%

Source: Company, MOSL

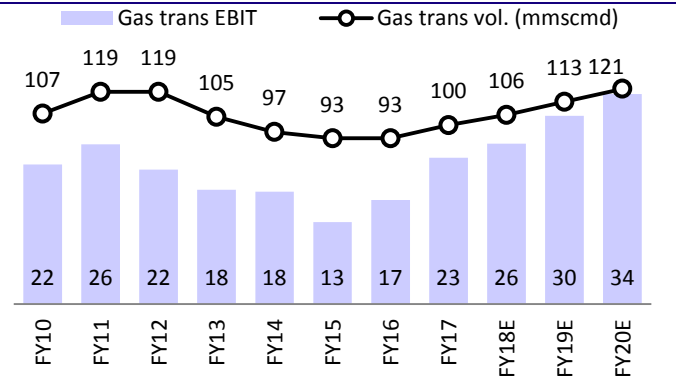
Story in charts

Exhibit 9: Transmission segment to remain major contributor to EBITDA



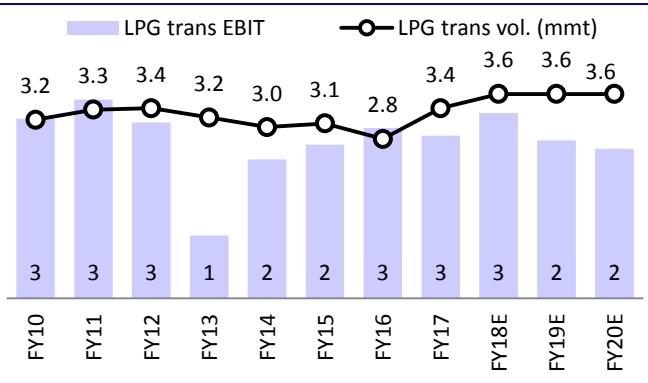
Source: Company, MOSL

Exhibit 10: Gas transmission volumes to grow by 7%/6% in FY19/20



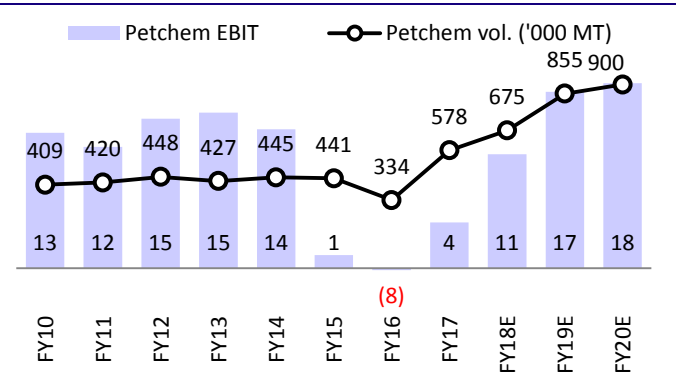
Source: Company, MOSL

Exhibit 11: LPG transmission EBIT is expected to grow by 21%/6% in FY18/19



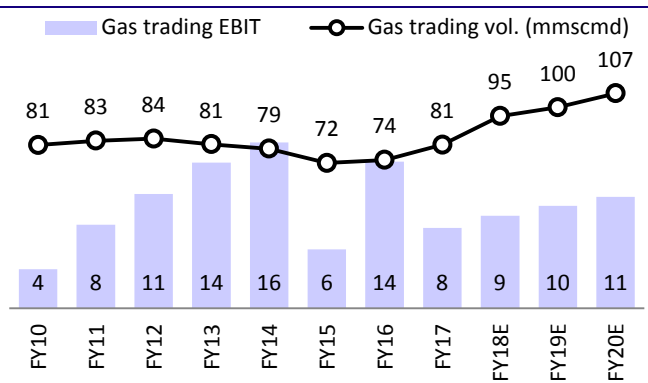
Source: Company, MOSL

Exhibit 12: Petchem EBIT is expected to increase in line with volume in FY19/20



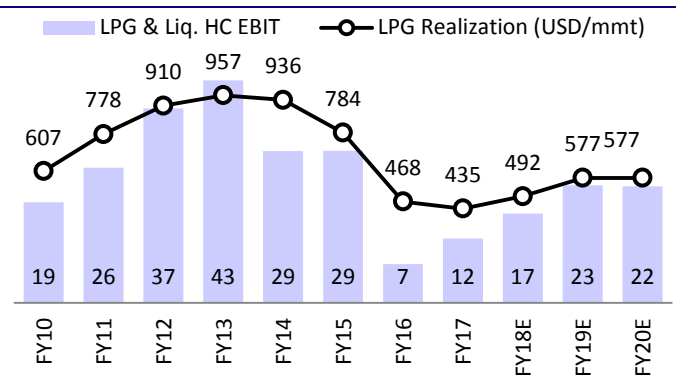
Source: Company, MOSL

Exhibit 13: Gas trading volume is expected to grow by 11%/9% in FY19/20



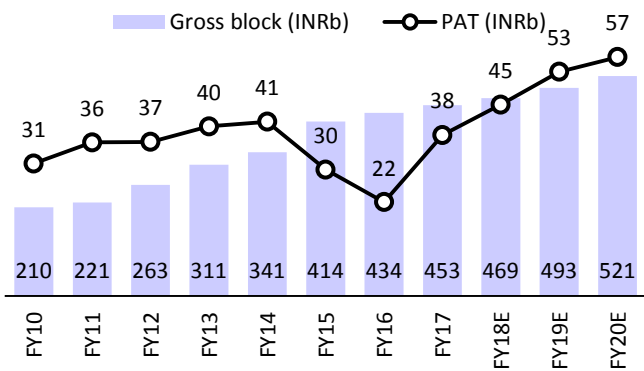
Source: Company, MOSL

Exhibit 14: LPG & Liq. HC EBIT is expected to increase in line with realization in FY19/20



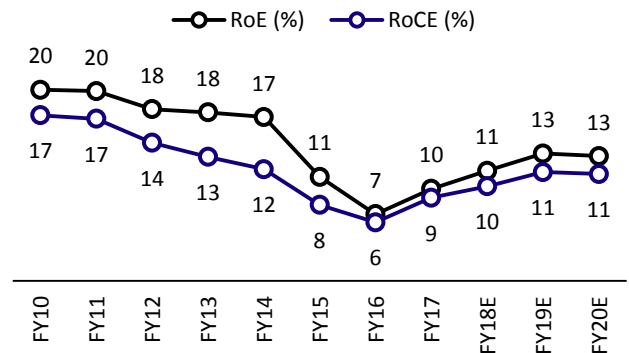
Source: Company, MOSL

Exhibit 15: PAT addition to lead gross block addition



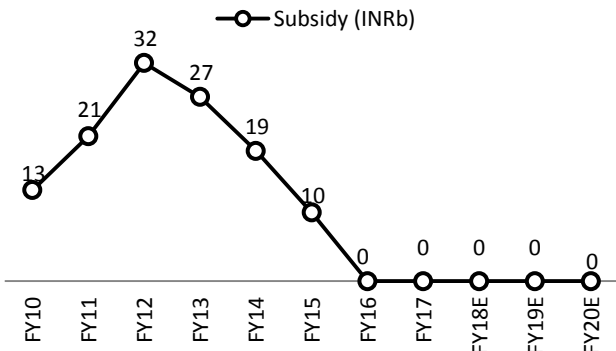
Source: Company, MOSL

Exhibit 16: Profitability to improve; return ratios to be subdued



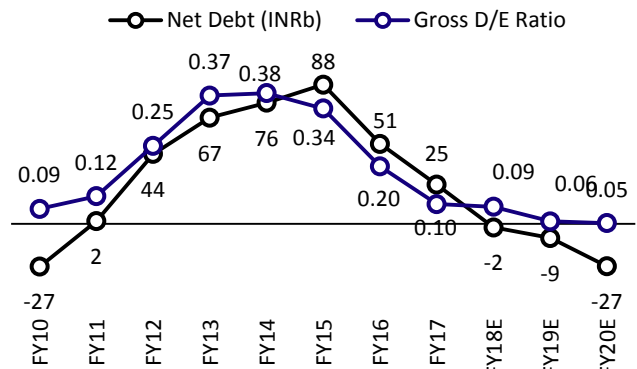
Source: Company, MOSL

Exhibit 17: Subsidy sharing ad-hoc; model nil in FY17/FY18/FY19



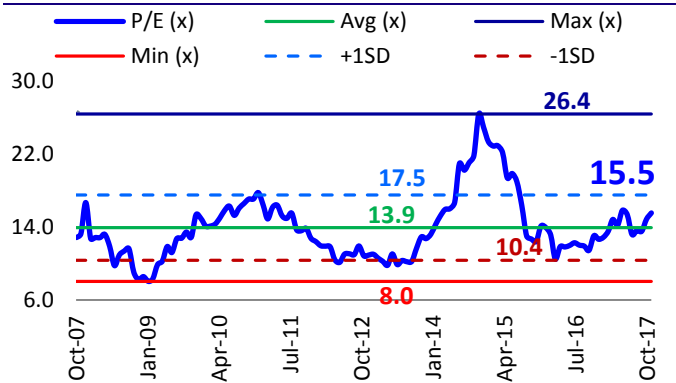
Source: Company, MOSL

Exhibit 18: D/E ratio is expected to come down



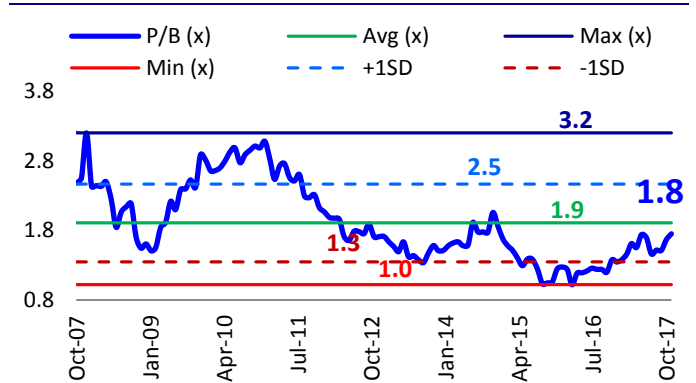
Source: Company, MOSL

Exhibit 19: 1-year forward P/E



Source: Company, MOSL

Exhibit 20: 1-year forward P/B (x)



Source: Company, MOSL

Financials and Valuations

Income Statement								(INR m)
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Net Sales	473,327	572,451	567,420	516,143	480,743	525,331	607,560	653,630
Change (%)	17.5	20.9	-0.9	-9.0	-6.9	9.3	15.7	7.6
Change in Stocks	570	6,269	-2,322	-4,116	-423	0	0	0
Purchases	333,969	412,344	403,483	384,480	286,997	319,927	366,743	396,589
Raw Materials	29,687	48,434	48,132	32,539	31,512	43,819	54,889	58,216
Employee Costs	7,855	8,477	9,064	9,961	12,575	15,090	16,599	18,259
Other expenses	38,455	29,915	62,101	54,319	86,930	68,913	81,124	87,321
EBITDA	62,792	67,012	46,962	38,960	63,152	77,582	88,203	93,245
% of Net Sales	13.3	11.7	8.3	7.5	13.1	14.8	14.5	14.3
Depreciation	9,809	11,762	9,743	13,131	13,968	14,267	14,734	15,363
Interest	1,950	3,662	3,613	6,400	4,794	3,437	2,850	2,262
Other Income	9,545	8,985	8,609	11,576	12,705	8,840	9,894	10,202
EO Items (net)		3,450	629		-2,987			
PBT	60,578	64,023	42,844	31,005	54,108	68,719	80,514	85,822
Tax	20,356	20,271	12,452	8,739	19,079	23,364	27,375	29,179
Rate (%)	33.6	31.7	29.1	28.2	35.3	34.0	34.0	34.0
Reported PAT	40,222	43,753	30,392	22,266	35,029	45,354	53,139	56,642
Adjusted PAT	40,222	41,310	29,947	22,266	38,167	45,354	53,139	56,642
Change (%)	10.1	8.8	-30.5	-26.7	57.3	29.5	17.2	6.6
Balance Sheet								(INR m)
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Share Capital	12,685	12,685	12,685	12,685	16,913	16,913	16,913	16,913
Reserves	229,593	258,039	278,510	338,261	364,581	392,831	425,930	461,212
Net Worth	242,278	270,723	291,195	350,946	381,494	409,744	442,843	478,125
Loans	90,635	102,973	99,361	68,457	38,186	38,187	25,138	25,138
Deferred Tax	23,001	25,664	33,087	40,714	46,559	53,431	61,482	70,065
Capital Employed	355,914	399,360	423,643	460,116	466,239	501,361	529,463	573,327
Gross Fixed Assets	311,490	340,563	413,893	433,777	452,646	468,672	493,046	521,487
Less: Depreciation	114,415	125,797	136,296	149,107	167,584	181,851	196,585	211,948
Net Fixed Assets	197,075	214,766	277,597	284,670	285,062	286,822	296,461	309,538
Capital WIP	89,778	97,279	43,600	34,202	38,034	50,534	78,114	95,534
Investments	37,190	41,030	43,224	85,847	95,096	95,096	95,096	95,096
Current Assets								
Inventory	15,353	22,548	20,811	16,094	16,984	15,922	17,181	18,049
Debtors	25,513	28,120	30,945	38,095	38,282	27,346	31,626	34,025
Cash & Bank Balance	23,579	26,510	11,416	17,939	13,419	40,395	31,580	45,704
Loans/Adv. & Other Assets	58,353	67,861	101,339	81,127	75,823	77,500	79,302	81,241
Current Liab. & Prov.								
Liabilities	72,980	80,224	89,154	86,355	81,327	82,686	88,529	92,541
Provisions	17,949	18,530	16,136	11,503	15,133	9,567	11,369	13,320
Net Current Assets	31,871	46,285	59,222	55,397	48,047	68,909	59,792	73,158
Application of Funds	355,914	399,360	423,643	460,116	466,239	501,361	529,463	573,326

Financials and Valuations

Ratios

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR)								
EPS	23.8	24.4	17.7	13.2	22.6	26.8	31.4	33.5
Cash EPS	29.6	32.8	23.7	20.9	29.0	35.3	40.1	42.6
Book Value	143.2	160.1	172.2	207.5	225.6	242.3	261.8	282.7
DPS	7.2	7.8	4.5	4.1	7.1	8.4	9.8	10.5
Payout (incl. dvd tax)	35.3	35.3	30.1	37.7	41.1	37.7	37.7	37.7
Valuation (x)								
P/E				35.6	20.7	17.5	14.9	14.0
Adj. P/E (for investments)				28.0	16.3	13.7	11.7	11.0
Cash P/E				22.4	16.2	13.3	11.7	11.0
EV / EBITDA				13.6	11.4	9.8	8.6	8.1
EV / Sales				1.3	1.8	1.6	1.4	1.3
Price / Book Value				2.3	2.1	1.9	1.8	1.7
Dividend Yield (%)				0.9	1.5	1.8	2.1	2.2
Profitability Ratios (%)								
RoE	17.5	17.1	10.8	6.9	9.6	11.5	12.5	12.3
RoCE	12.9	11.6	7.9	6.1	8.7	9.8	10.7	10.5
RoIC	19.1	17.2	9.4	5.7	9.9	13.2	15.2	15.5
Turnover Ratios								
Debtors (No. of Days)	20	18	20	27	29	19	19	19
Fixed Asset Turnover (x)	1.3	1.4	1.3	1.1	1.0	1.0	1.1	1.1
Leverage Ratio								
Net Debt / Equity (x)	0.28	0.28	0.30	0.14	0.06	0.0	0.0	0.0

Cash Flow Statement

(INR m)

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
OP/(Loss) before Tax	60,578	64,023	42,844	31,728	54,108	68,719	80,514	85,822
Depreciation	10,202	11,801	9,807	13,144	13,968	14,267	14,734	15,363
Other op items	1,067	-4,186	460	4,355	0	0	0	0
Direct Taxes Paid	-15,129	-18,738	-8,551	-7,039	-13,345	-16,493	-19,323	-20,597
(Inc)/Dec in Wkg. Capital	-6,384	-8,171	-19,567	6,161	2,830	6,114	302	758
CF from Op. Activity	50,334	44,729	24,993	48,349	57,561	72,607	76,227	81,346
(Inc)/Dec in FA & CWIP	-54,968	-38,364	-16,942	-13,433	-22,701	-28,526	-51,953	-45,861
Free Cash Flow	-4,634	6,365	8,051	34,917	34,859	44,081	24,273	35,485
(Pur)/Sale of Investments	-4,062	114	427	-2,243	2,243	0	0	0
Inc from Invst	4,309	5,933	6,319	5,563	3,040	0	0	0
CF from Inv. Activity	-54,722	-32,317	-10,197	-10,113	-17,418	-28,526	-51,953	-45,861
Issue of Shares	0	0	0	0	0	0	0	0
Inc / (Dec) in Debt	32,953	5,510	-16,569	-23,314	-30,270	0	-13,049	0
Dividends Paid	-14,299	-14,991	-13,321	-8,400	-14,393	-17,104	-20,040	-21,361
CF from Fin. Activity	18,654	-9,481	-29,890	-31,714	-44,664	-17,104	-33,089	-21,361
Inc / (Dec) in Cash	14,266	2,930	-15,093	6,522	-4,521	26,977	-8,815	14,124
Add: Opening Balance	9,314	23,580	26,510	11,417	17,939	13,418	40,395	31,580
Closing Balance	23,580	26,510	11,417	17,939	13,418	40,395	31,580	45,704

NOTES

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