

BSE SENSEX  
 46,253

 S&P CNX  
 13,558

**Stock Info**

Bloomberg	GAIL IN
Equity Shares (m)	4,510
M.Cap.(INRb)/(USDb)	566 / 7.7
52-Week Range (INR)	133 / 66
1, 6, 12 Rel. Per (%)	28/-7/-8
12M Avg Val (INR M)	1654
Free float (%)	48.2

**Financials Snapshot (INR b)**

Y/E March	FY21E	FY22E	FY23E
Sales	576.4	712.8	741.6
EBITDA	54.6	97.4	102.0
Adj. PAT	37.6	69.1	72.9
Adj. EPS (INR)	8.3	15.3	16.2
EPS Gr. (%)	-49.3	83.8	5.5
BV/Sh.(INR)	111.3	121.2	131.8

**Ratios**

Net D:E	0.1	0.1	0.1
RoE (%)	8.3	14.2	13.7
RoCE (%)	7.0	11.7	11.5
Payout (%)	35.0	35.0	35.0

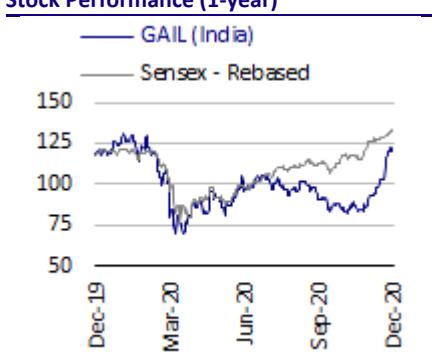
**Valuations**

P/E (x)	15.1	8.2	7.8
P/BV (x)	1.1	1.0	1.0
EV/EBITDA (x)	8.6	5.4	5.0
Div. Yield (%)	1.9	3.5	3.7
FCF Yield (%)	-2.7	6.9	6.1

**Shareholding pattern (%)**

As On	Sep-20	Jun-20	Sep-19
Promoter	37.6	37.6	37.6
DII	30.9	33.6	33.9
FII	15.6	15.5	15.5
Others	15.9	13.2	12.9

FII Includes depository receipts

**Stock Performance (1-year)**

**CMP: INR126 TP: INR155 (+24%)**
**Buy**
**Improving macros to drive earnings/rerating**

- Owing to the huge demand supply mismatch across the globe on the path of normalization in the post COVID world, spot LNG prices and petchem margins are trending at multi-year highs. GAIL has reported concerns in its Gas trading and Petchem segment in 1HFY21, which are now likely to see some gains.
- GAIL has outperformed the Nifty by ~30% (rallying ~36%) over the last one-month and since its 2QFY21 result. Despite the recent rally, GAIL is trading at 5.4x FY22E EV/EBITDA and 8.2x FY22E P/E.
- Changing macros, if sustained, could result in an earnings/target price upgrade.
- The company also has strong tailwinds such as (a) boost in transmission volumes from increased domestic gas production, (b) upcoming LNG terminals, and (c) the NGT's increasing impetus on curbing air pollution
- We reiterate GAIL as one of our top large-cap picks in the sector.

**Spurt in spot LNG prices**

- GAIL sells ~10mm scmd of LNG outside India. Although it tries to cover its high-cost US HH contracts via various swap/time/destination swap/hedging contracts, an adverse situation of low oil prices combined with low spot LNG prices results in poor profitability. The company reportedly witnessed a loss in its marketing segment in 1HFY21.
- From the lows of USD2.2/mmBtu in May'20, spot LNG prices recovered due to shutdowns in liquefaction plants and recovery in demand to USD8/mmBtu for Feb'21 delivery ([link](#)).
- Combined with this, restart of the Kochi-Mangalore pipeline and pre-commissioning of Gorakhpur, Sindri and Barauni fertilizer plants along the Jagdishpur-Haldia pipeline would eliminate all concerns on US HH contracts by mid-2021.

**Spurt in short-term petchem margin to aid profitability**

- Delayed normalization in demand for refined petroleum products, disruptions in few large petchem plants, and revival in demand has resulted in short-term relief on petchem margins. PE-naphtha/PP-naphtha margin is up 75%/107% YoY and 19%/47% QoQ in 3QFY21 till date.
- Many Chinese and Middle East petchem expansions are still underway, which may bring down margins going forward.
- Due to difficulty in placing high-cost US HH contracts, it is understood that GAIL had to use some part of the high cost gas as feedstock in its petchem plant. With the waning of concerns on these contracts, profitability of the petchem segment would also be boosted.

**Expect large spurt in transmission volumes**

- Conservatively, we forecast a transmission volume of 104/120/125mm scmd in FY21E/FY22E/FY23E v/s 108mm scmd in FY20. We also highlight that gas availability in India is expected to witness a sharp jump going forward.
- From the KG-basin itself, over the next 2-3 years, both RIL and ONGC are expected to produce an incremental 43mm scmd of gas, most of which would flow through GAIL's network.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

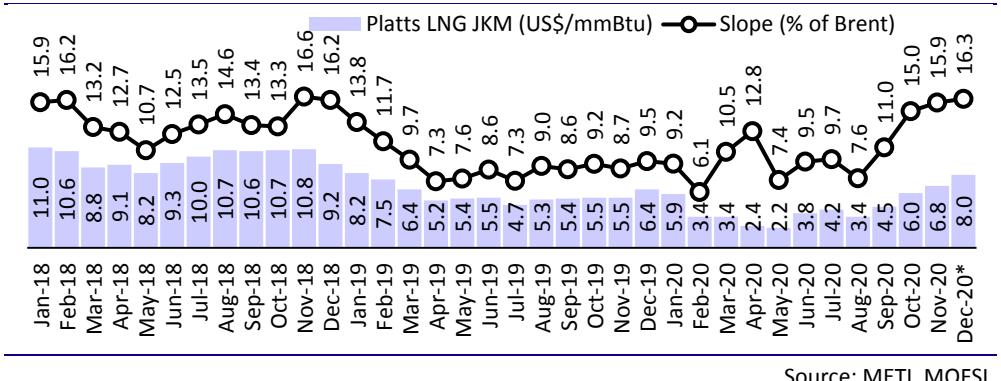
 Motilal Oswal research is available on [www.motilaloswal.com](http://www.motilaloswal.com)/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

- In the next 2-3 years, 18mmtpa of incremental LNG regas facility (~76% of FY20 imports of ~23.6mmtpa) would be available (Dabhol: 2mmtpa, Mundra: 2.5mmtpa, Kochi: 1.5mmtpa, Dahej: 2mmtpa, Swan: 5mmtpa, and Chhara: 5mmtpa). Although all would not be utilized immediately post availability, it would ultimately aid GAIL's transmission volumes.
- We highlight that an increase of 10mmscmd in transmission volume would result in ~6/7% rise in FY22E EBITDA/PAT.

### Valuation and recommendation

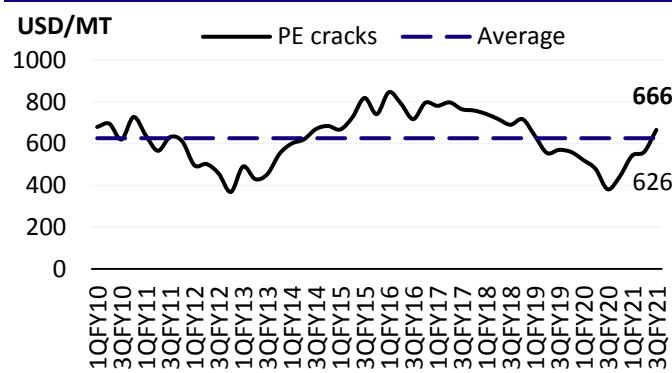
- The main concern of investors over GAIL was its US HH contracts. But commissioning of three fertilizer plants on the Jagdishpur-Haldia pipeline by mid-2021 would mitigate these concerns.
- In the meantime, spurt in spot LNG prices as well as petchem margins would help the stock in the short-term.
- GAIL is trading at 5.4x FY22E EV/EBITDA and 8.2x FY22E P/E. We forecast a modest INR973/1,022/mscm of marketing margin on LNG in FY22E/FY23E v/s 1,327/973/mscm in FY19/FY20. As per our estimate sensitivity, a 10% rise in implied trading margin would result in ~2% rise in FY22E EBITDA/EPS.
- Despite the 30% outperformance in the last month, the stock trades at a 35% and 38% discount to its one-year forward long-term P/E and P/B average, respectively. **We reiterate GAIL as one of our top large-picks with a target price of INR155 (valuing at 8x Dec'22E adjusted EPS).**
- As various aforementioned factors come into play, the stock would see a re-rating, thus implying huge potential upside (please refer Exhibit 4 for various valuation snapshots).

### Exhibit 1: Spot LNG prices at two-year high, slope climbs to ~16%



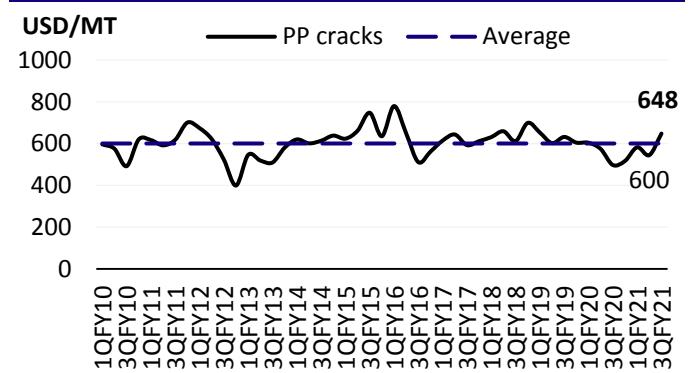
Source: METI, MOFSL

### Exhibit 2: PE and PP up 6-8% v/s its long-term average in 3QFY21 till date...



Source: Bloomberg, MOFSL

### Exhibit 3: ...as product prices are up, while Naphtha prices are down



Source: Bloomberg, MOFSL

## Valuations and key assumptions

Exhibit 4: Valuation summary

Business	Base case	Long-term average			Remarks
	INR/share	INR/share	INR/share		
	8.0	10.0	13.0		
Core business	121	151	196	Dec'22E adjusted EPS	
Listed investments	28	28	28	20% discount to CMP/target price	
Unlisted investments	6	6	6	20% discount to book value	
<b>Target price</b>	<b>155</b>	<b>185</b>	<b>230</b>		

Source: MOFSL

Exhibit 5: Key assumptions table

	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Brent crude (USD/bbl)	47.5	49.0	55.6	70.1	61.2	40.4	50.0	50.0
Exchange rate (INR/USD)	65.5	67.1	64.6	69.9	70.9	74.9	75.8	75.8
<b>Natural gas transmission</b>								
Total (mmscmd)	93	100	105	107	108	104	120	125
Adj. average tariff (INR/mscm)	1,181	1,257	1,295	1,473	1,522	1,554	1,575	1,579
Trading volume	74	81	85	97	96	88	103	108
<b>LPG transmission</b>								
Volume ('000 MT)	2,819	3,363	3,721	3,975	3,909	4,300	4,730	5,203
Average tariff (INR/MT)	1,724	1,530	1,532	1,570	1,628	1,628	1,628	1,628
<b>Petrochemicals</b>								
Sales ('000 MT)	334	578	673	735	738	760	800	800
Realization (USD/MT)	1,420	1,468	1,362	1,313	1,047	961	965	965
<b>LPG and liquid hydrocarbons</b>								
Sales ('000 MT)	1,087	1,095	1,275	1,325	1,266	1,283	1,400	1,498
LPG realization (USD/MT)	468	435	526	549	472	404	451	451
<b>EPS (INR/share)</b>	<b>5.1</b>	<b>8.5</b>	<b>10.1</b>	<b>14.0</b>	<b>16.5</b>	<b>8.3</b>	<b>15.3</b>	<b>16.2</b>

Source: MOFSL

Exhibit 6: One-year forward P/E at a 35% discount to its long-term average of 13.2x

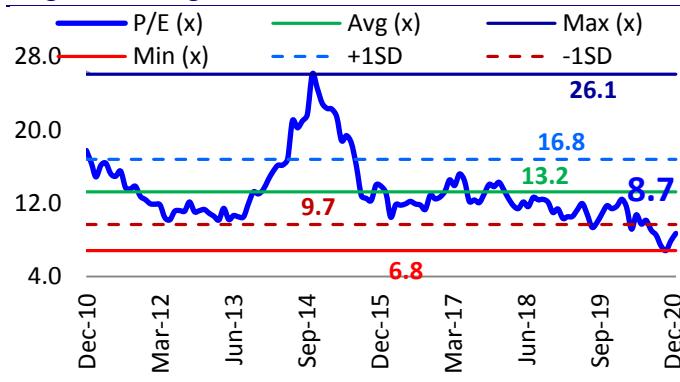
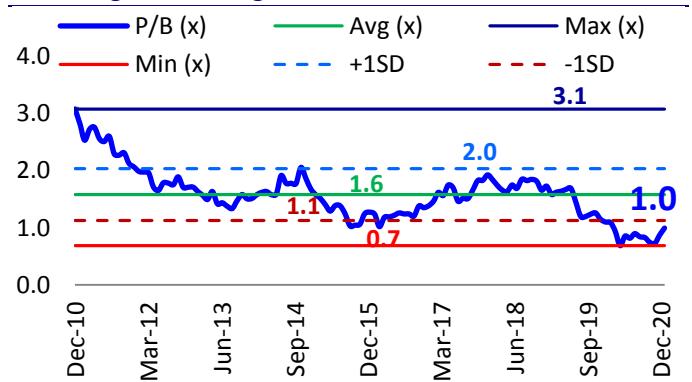
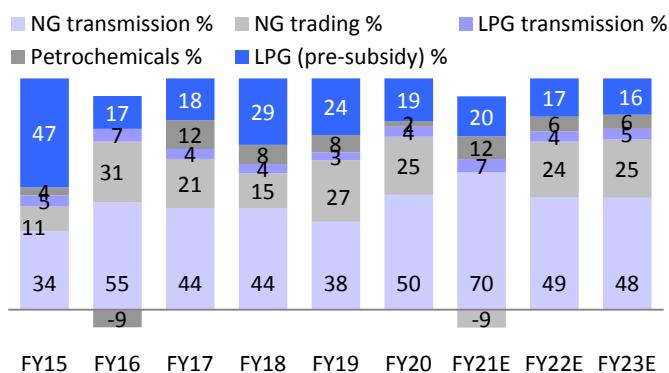
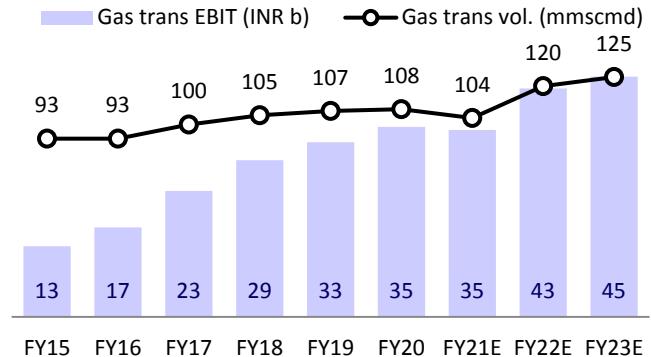


Exhibit 7: One-year forward P/B (x) trades at a 38% discount to its long-term average of 1.6x

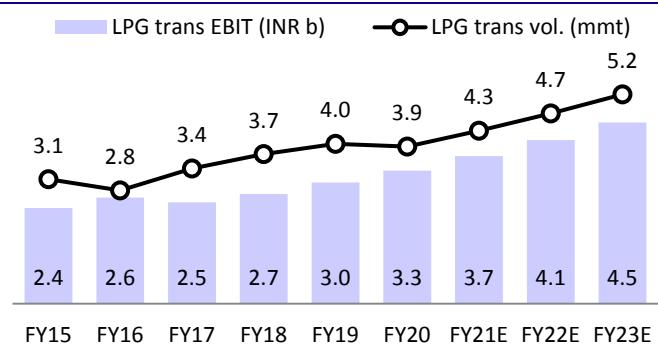


**Exhibit 8: Transmission to remain major contributor**

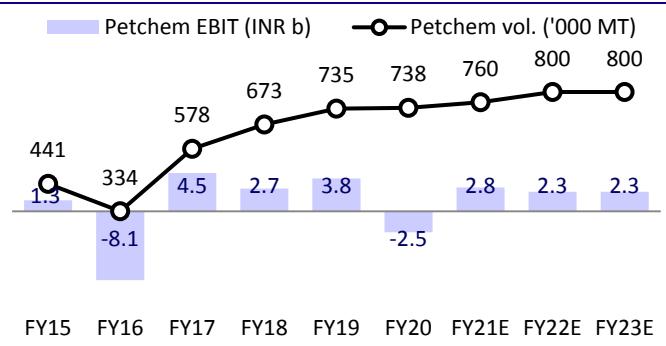
Source: Company, MOFSL

**Exhibit 9: Gas transmission volumes to grow**

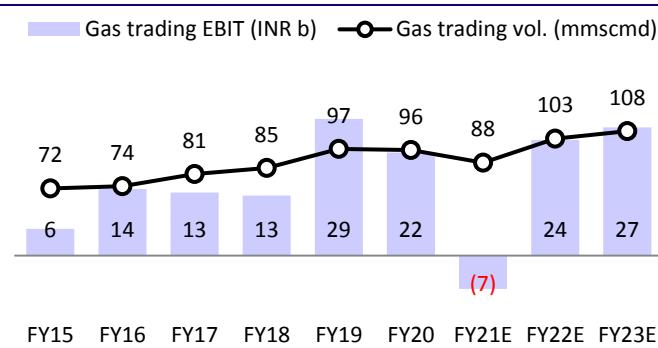
Source: Company, MOFSL

**Exhibit 10: LPG transmission segment EBIT**

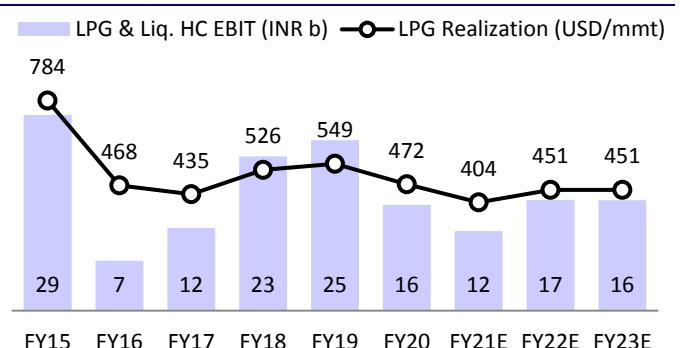
Source: Company, MOFSL

**Exhibit 11: Petchem segment EBIT**

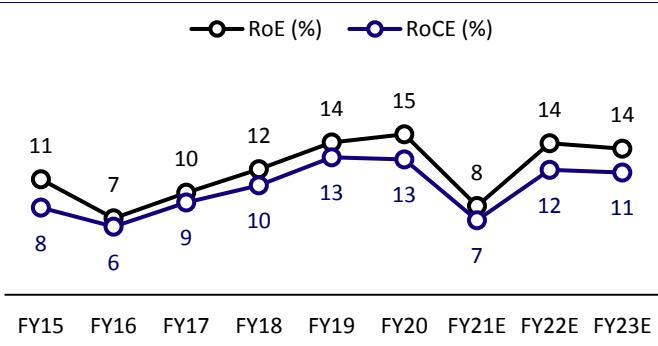
Source: Company, MOFSL

**Exhibit 12: Expect gas trading volume to grow in FY20/FY21**

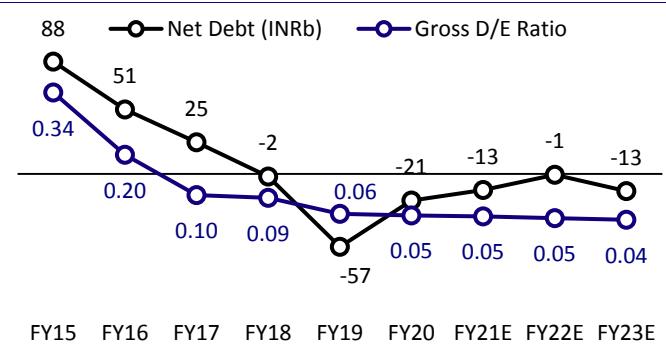
Source: Company, MOFSL

**Exhibit 13: Expect LPG and liquid hydrocarbons EBIT to improve along with realization in FY20/FY21**

Source: Company, MOFSL

**Exhibit 14: Return ratios to improve**

Source: Company, MOFSL

**Exhibit 15: Expect D/E ratio to decline**

Source: Company, MOFSL

## Financials and valuations

Income Statement								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Net Sales</b>	<b>5,16,143</b>	<b>4,80,743</b>	<b>5,36,612</b>	<b>7,51,268</b>	<b>7,18,764</b>	<b>5,76,354</b>	<b>7,12,779</b>	<b>7,41,637</b>
Change (%)	-9.0	-6.9	11.6	40.0	-4.3	-19.8	23.7	4.0
<b>EBITDA</b>	<b>39,684</b>	<b>63,152</b>	<b>76,339</b>	<b>95,287</b>	<b>83,694</b>	<b>54,566</b>	<b>97,392</b>	<b>1,01,973</b>
% of Net Sales	7.7	13.1	14.2	12.7	11.6	9.5	13.7	13.7
Depreciation	13,131	13,968	14,151	15,502	18,360	18,681	18,923	19,178
Interest	6,400	4,794	2,751	1,385	1,085	1,414	1,750	1,750
Other Income	11,576	12,705	9,870	15,712	14,168	14,877	15,621	16,402
EO Items (net)	-2,987	277	-3,263	1,016				
<b>PBT</b>	<b>31,728</b>	<b>54,108</b>	<b>69,584</b>	<b>90,848</b>	<b>79,434</b>	<b>49,348</b>	<b>92,340</b>	<b>97,447</b>
Tax	8,739	19,079	23,400	30,592	13,227	11,745	23,242	24,527
Rate (%)	27.5	35.3	33.6	33.7	16.7	23.8	25.2	25.2
<b>Reported PAT</b>	<b>22,989</b>	<b>35,029</b>	<b>46,183</b>	<b>60,257</b>	<b>66,206</b>	<b>37,603</b>	<b>69,098</b>	<b>72,919</b>
<b>Adjusted PAT</b>	<b>22,989</b>	<b>38,167</b>	<b>45,699</b>	<b>63,264</b>	<b>74,193</b>	<b>37,603</b>	<b>69,098</b>	<b>72,919</b>
Change (%)	-24.4	52.4	31.8	30.5	9.9	-43.2	83.8	5.5
Balance Sheet								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	12,685	16,913	22,551	22,551	45,101	45,101	45,101	45,101
Reserves	3,38,261	3,64,581	3,80,731	4,18,379	3,94,610	4,19,069	4,64,015	5,11,447
<b>Net Worth</b>	<b>3,50,946</b>	<b>3,81,494</b>	<b>4,03,281</b>	<b>4,40,929</b>	<b>4,39,711</b>	<b>4,64,171</b>	<b>5,09,116</b>	<b>5,56,548</b>
Loans	68,457	38,186	17,517	16,157	43,098	70,000	70,000	70,000
Deferred Tax	40,714	46,559	46,309	59,477	44,972	44,972	44,972	44,972
<b>Capital Employed</b>	<b>4,60,116</b>	<b>4,66,239</b>	<b>4,67,108</b>	<b>5,16,564</b>	<b>5,27,781</b>	<b>5,79,143</b>	<b>6,24,088</b>	<b>6,71,520</b>
Gross Fixed Assets	4,33,777	4,52,646	4,69,633	5,08,099	5,48,260	6,08,476	6,68,476	7,28,476
Less: Depreciation	1,49,107	1,67,584	1,81,736	1,97,238	2,15,598	2,34,278	2,53,201	2,72,379
<b>Net Fixed Assets</b>	<b>2,84,670</b>	<b>2,85,062</b>	<b>2,87,898</b>	<b>3,10,861</b>	<b>3,32,662</b>	<b>3,74,198</b>	<b>4,15,275</b>	<b>4,56,097</b>
Capital WIP	34,202	38,034	55,140	92,025	1,05,819	1,05,603	1,05,603	1,05,603
Investments	85,847	95,096	99,531	95,282	78,772	78,772	78,772	78,772
<b>Current Assets</b>								
Inventory	16,094	16,984	19,195	23,219	29,601	23,736	29,354	30,543
Debtors	38,095	38,282	40,515	50,743	55,759	44,712	55,295	57,534
Cash & Bank Balance	17,939	13,419	25,294	12,147	8,039	6,323	21,457	30,449
Loans/Adv. & Other Assets	81,127	75,823	99,558	59,510	74,684	74,684	74,684	74,684
<b>Current Liab. &amp; Prov.</b>								
Liabilities	86,355	81,327	1,45,740	1,12,969	1,44,709	1,16,037	1,43,504	1,49,314
Provisions	11,503	15,133	14,283	14,253	12,847	12,847	12,847	12,847
<b>Net Current Assets</b>	<b>55,397</b>	<b>48,047</b>	<b>24,539</b>	<b>18,397</b>	<b>10,527</b>	<b>20,570</b>	<b>24,439</b>	<b>31,049</b>
<b>Application of Funds</b>	<b>4,60,116</b>	<b>4,66,239</b>	<b>4,67,108</b>	<b>5,16,564</b>	<b>5,27,781</b>	<b>5,79,143</b>	<b>6,24,088</b>	<b>6,71,520</b>

E: MOFSL estimates

## Financials and valuations

### Ratios

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Basic (INR)</b>								
EPS	<b>5.1</b>	<b>8.5</b>	<b>10.1</b>	<b>14.0</b>	<b>16.5</b>	<b>8.3</b>	<b>15.3</b>	<b>16.2</b>
Cash EPS	8.0	10.9	13.4	16.8	18.8	12.5	19.5	20.4
Book Value	77.8	84.6	90.2	98.9	105.9	111.3	121.2	131.8
DPS	1.5	3.2	3.9	3.8	6.4	2.4	4.4	4.7
Payout (incl. dvd. tax)	36.5	50.1	45.5	34.7	52.5	35.0	35.0	35.0
<b>Valuation (x)</b>								
P/E	24.7	14.9	12.4	9.0	7.7	15.1	8.2	7.8
Adj. P/E (for investments)	18.1	10.9	9.1	6.6	5.6	11.0	6.0	5.7
Cash P/E	15.7	11.6	9.4	7.5	6.7	10.1	6.5	6.2
EV / EBITDA	4.9	3.7	3.9	2.6	6.0	8.6	5.4	5.0
EV / Sales	0.5	0.6	0.6	0.4	0.8	1.0	0.9	0.8
Price / Book Value	1.6	1.5	1.4	1.3	1.2	1.1	1.0	1.0
Dividend Yield (%)	1.2	2.5	3.1	3.0	5.1	1.9	3.5	3.7
<b>Profitability ratios (%)</b>								
RoE	7.2	9.6	11.8	14.3	15.0	8.3	14.2	13.7
RoCE	6.4	8.7	10.2	12.9	12.7	7.0	11.7	11.5
RoIC	7.0	9.9	13.6	17.5	16.7	7.6	14.6	14.2
<b>Turnover ratios</b>								
Debtors (No. of Days)	27	29	28	25	28	28	28	28
Fixed Asset Turnover (x)	1.1	1.0	1.1	1.5	1.4	1.0	1.1	1.1
<b>Leverage ratio</b>								
Net Debt/Equity (x)	0.14	0.06	-0.02	0.01	0.08	0.1	0.1	0.1

### Cash Flow Statement

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>(INR m)</b>								
OP/(Loss) before Tax	31,728	54,108	69,584	90,848	79,434	49,348	92,340	97,447
Depreciation	13,131	13,968	14,151	15,502	18,360	18,681	18,923	19,178
Tax paid	-8,739	-19,079	-23,400	-30,592	-13,227	-11,745	-23,242	-24,527
Change in deferred tax liability	7,627	5,845	-250	13,168	-14,505	0	0	0
(Inc)/Dec in Wkg. Capital	-8,531	2,830	35,383	-7,004	3,762	-11,759	11,265	2,383
<b>CF from Op. Activity</b>	<b>35,216</b>	<b>57,672</b>	<b>95,468</b>	<b>81,922</b>	<b>73,823</b>	<b>44,525</b>	<b>99,286</b>	<b>94,480</b>
(Inc)/Dec in FA and CWIP	-10,805	-18,192	-34,094	-75,350	-53,956	-60,000	-60,000	-60,000
<b>Free Cash Flow</b>	<b>24,411</b>	<b>39,480</b>	<b>61,375</b>	<b>6,573</b>	<b>19,867</b>	<b>-15,475</b>	<b>39,286</b>	<b>34,480</b>
(Pur)/Sale of Investments	-42,624	-9,249	-4,434	4,249	16,510	0	0	0
<b>CF from Inv. Activity</b>	<b>-53,429</b>	<b>-27,441</b>	<b>-38,528</b>	<b>-71,101</b>	<b>-37,446</b>	<b>-60,000</b>	<b>-60,000</b>	<b>-60,000</b>
Inc /(Dec) in Debt	-12,026	-30,270	-20,669	-1,360	26,940	26,902	0	0
Dividends Paid	-8,399	-17,535	-21,035	-20,901	-34,791	-13,144	-24,152	-25,488
<b>CF from Fin. Activity</b>	<b>24,735</b>	<b>-34,751</b>	<b>-45,065</b>	<b>-23,968</b>	<b>-40,484</b>	<b>13,759</b>	<b>-24,152</b>	<b>-25,488</b>
<b>Inc /(Dec) in Cash</b>	<b>6,522</b>	<b>-4,520</b>	<b>11,875</b>	<b>-13,147</b>	<b>-4,108</b>	<b>-1,716</b>	<b>15,134</b>	<b>8,993</b>
Add: Opening Balance	11,416	17,939	13,419	25,294	12,147	8,039	6,323	21,457
<b>Closing Balance</b>	<b>17,939</b>	<b>13,419</b>	<b>25,294</b>	<b>12,147</b>	<b>8,039</b>	<b>6,323</b>	<b>21,457</b>	<b>30,449</b>

E: MOFSL estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

\*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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