

June 15, 2009

Rating	Reduce
Price	Rs283
Target Price	Rs285
Implied Upside	1.0%
Sensex	14,876

(Prices as on June 15, 2009)

Trading Data

Market Cap. (Rs bn)	358.5
Shares o/s (m)	1,268.5
Free Float	41.8%
3M Avg. Daily Vol ('000)	382.7
3M Avg. Daily Value (Rs m)	102.2

Major Shareholders

Promoters	58.2%
Foreign	13.1%
Domestic Inst.	25.3%
Public & Others	3.4%

Stock Performance

(%)	1M	6M	12M
Absolute	4.9	27.5	11.3
Relative	(17.3)	(23.8)	13.4

Price Performance (RIC: GAIL.BO, BB: GAIL IN)



Source: Bloomberg

GAIL

Petchem realisations up, no subsidies

- **Revenue jump led by higher petchem, gas realisations:** GAIL revenues surged by 26.3% YoY to Rs62.3bn (Rs49.4bn), led by higher petchem realisations, coupled with higher contribution from the natural gas trading business. The topline growth during Q4FY09 was also aided by zero subsidy sharing.
- **Write-off on E&P impacts EBITDA margins:** Although GAIL was protected from subsidy burden, higher write-off on dry well expenditure on E&P business led to EBITDA margin decline. The EBITDA margins, thus, declined by 610bps YoY to 17.4% (23.5%) which was better than our expectation of 14.9%. However, the decline was partially arrested by higher Petchem realisations, with petchem EBITDA margin of 54.2%. The operating profit decreased by 6.3% YoY to Rs10.9bn (Rs11.6bn).
- **Higher tax outgo impacts PAT:** GAIL provided tax at higher effective tax rate of 37.0% which, along with lower other income, led to 12.8% YoY decline in PAT at Rs6.3bn (Rs7.2bn). However, this was better than our expectation of Rs5.3bn.
- **Valuations:** We believe that an improvement in the global petchem prices will help GAIL's revenues as well as petchem EBITDA margins. Also, the subsidy burden for FY10 will be much lesser than FY09, arresting the decline in profitability. However, ambiguity over HBJ pipeline tariff still remains. We believe that the positives have been factored in GAIL price and hence, we maintain our 'Reduce' rating on the stock.

Key financials (Y/e March)	FY08	FY09	FY10E	FY11E
Revenues (Rs m)	180,082	239,533	255,267	299,408
Growth (%)	12.2	33.0	6.6	17.3
EBITDA (Rs m)	39,275	42,317	45,965	50,236
PAT (Rs m)	26,015	28,037	31,297	34,414
EPS (Rs)	20.5	22.1	24.7	27.1
Growth (%)	9.0	7.8	11.6	10.0
Net DPS (Rs)	10.0	7.0	8.0	9.0

Source: Company Data; PL Research

Profitability & valuation	FY08	FY09	FY10E	FY11E
EBITDA margin (%)	21.8	17.7	18.0	16.8
RoE (%)	21.3	20.2	19.9	19.4
RoCE (%)	17.9	17.4	17.4	17.3
EV / sales (x)	1.8	1.3	1.2	1.0
EV / EBITDA (x)	8.3	7.6	6.9	6.2
PE (x)	13.8	12.8	11.5	10.4
P / BV (x)	2.8	2.4	2.1	1.9
Net dividend yield (%)	3.5	2.5	2.8	3.2

Source: Company Data; PL Research

Rohit Nagraj
RohitNagraj@PLIndia.com
+91-22-6632 2241



Q4FY09 Result Overview

(Rs m)

Y/e March	Q4FY09	Q4FY08	YoY gr. (%)	Q3FY09	FY09	FY08	YoY gr. (%)
Net Sales	62,340	49,353	26.3	58,160	239,533	180,520	32.7
Expenditure							
Raw material	44,926	31,676	41.8	47,582	172,037	118,856	44.7
<i>% of net sales</i>	<i>72.1</i>	<i>64.2</i>		<i>81.8</i>	<i>71.8</i>	<i>65.8</i>	
Personnel cost	495	2,203	(77.6)	3,226	5,767	4,770	20.9
<i>% of net sales</i>	<i>0.8</i>	<i>4.5</i>		<i>5.5</i>	<i>2.4</i>	<i>2.6</i>	
Other operating expenses	6,048	3,874	56.1	4,649	19,413	16,964	14.4
<i>% of net sales</i>	<i>9.7</i>	<i>7.8</i>		<i>8.0</i>	<i>8.1</i>	<i>9.4</i>	
EBITDA	10,871	11,600	(6.3)	2,703	42,317	39,931	6.0
<i>Margin (%)</i>	<i>17.4</i>	<i>23.5</i>		<i>4.6</i>	<i>17.7</i>	<i>22.1</i>	
Depreciation	1,410	1,425	(1.0)	1,374	5,599	5,710	(1.9)
EBIT	9,462	10,175	(7.0)	1,330	36,717	34,221	7.3
Interest	306	195	56.5	185	870	796	9.3
Other Income	881	997	(11.6)	2,308	6,193	5,125	20.8
PBT	10,037	10,976	(8.6)	3,452	42,040	38,550	9.1
Total taxes	3,716	3,733	(0.5)	893	13,926	12,460	11.8
<i>ETR (%)</i>	<i>37.0</i>	<i>34.0</i>		<i>25.9</i>	<i>33.1</i>	<i>32.3</i>	
FBT	21	19	8.9	25	77	75	2.5
PAT	6,300	7,224	(12.8)	2,534	28,037	26,015	7.8

Segmental breakup

(Rs m)

Y/e March	Q4FY09	Q4FY08	YoY gr. (%)	Q3FY09	FY09	FY08	YoY gr. (%)
Natural gas trading	47,430	33,802	40.3	49,507	183,084	126,577	44.6
Petrochemicals	6,813	7,467	(8.8)	6,227	27,335	25,912	5.5
LPG & Liquid hydrocarbons	7,671	7,898	(2.9)	3,330	29,900	26,614	12.3
Transmission - Natural gas	6,511	5,762	13.0	6,141	25,081	22,865	9.7
Transmission - LPG	992	1,079	(8.0)	1,065	3,819	3,893	(1.9)
Gailtel	49	72	(31.5)	64	243	286	(14.8)
Unallocated	63	1,055	(94.0)	2,526	5,749	5,064	13.5
Total	69,530	57,133	21.7	68,860	275,211	211,210	30.3
Less: Intersegmental	8,487	6,784	25.1	8,392	31,663	25,564	23.9
Gross Sales	61,043	50,350	21.2	60,468	243,548	185,646	31.2
EBIT							
Natural gas trading	592	692	(14.4)	823	3,476	2,044	70.1
Petrochemicals	3,275	3,628	(9.7)	1,297	12,254	12,542	(2.3)
LPG & Liquid hydrocarbons	2,240	3,533	(36.6)	(2,473)	8,696	9,004	(3.4)
Transmission - Natural gas	4,342	3,755	15.6	3,591	16,223	15,535	4.4
Transmission - LPG	640	688	(7.0)	615	2,261	2,318	(2.5)
Gailtel	(17)	4	(522.5)	9	(41)	31	(232.5)
Unallocated	(1,650)	(1,128)	46.2	(224)	(880)	(2,129)	(58.7)
Total EBIT	9,422	11,172	(15.7)	3,637	41,989	39,346	6.7
EBIT Margins (%)							
<i>Natural gas trading</i>	1.2	2.0		1.7	1.9	1.6	
<i>Petrochemicals</i>	48.1	48.6		20.8	44.8	48.4	
<i>LPG & Liquid hydrocarbons</i>	29.2	44.7		(74.3)	29.1	33.8	
<i>Transmission - Natural gas</i>	66.7	65.2		58.5	64.7	67.9	
<i>Transmission - LPG</i>	64.4	63.7		57.8	59.2	59.6	
<i>Gailtel</i>	(34.4)	5.6		14.2	(16.9)	10.9	

EBITDA margin Performance

(%)

Y/e March	Q4FY09	Q4FY08	Q3FY09	FY09	FY08
Natural gas trading	1.5	2.6	2.0	2.3	2.0
Petrochemicals	54.2	54.5	27.6	51.2	54.6
LPG & Liquid hydrocarbons	32.1	47.9	(67.9)	32.3	37.6
Transmission - Natural gas	85.7	88.2	77.1	84.3	89.2
Transmission - LPG	81.8	80.4	74.5	77.6	78.5
Gailtel	0.0	42.9	33.3	12.5	46.4



Volume breakup

Y/e March	Q4FY09	Q4FY08	YoY gr. (%)	Q3FY09	FY09	FY08	YoY gr. (%)
NG Transmission Services (mmscmd)	83	82	0.5	84	83	82	1.4
LPG Transmission Services (TMTs)	715	783	(8.7)	763	2,744	2,754	(0.4)
Natural Gas Trading (mmscmd)	77	69	12.5	80	79	69	14.4
Petro Chemicals (TMTs)	104	109	(4.6)	130	413	391	5.6
LPG (TMTs)	257	250	2.8	279	1,088	1,039	4.7
Other Liquid Hydrocarbons (TMTs)	83	73	13.7	75	313	304	3.0

Highlights

Natural gas transmission: Surge in average realisations

Natural gas transmission volumes remained flattish on a YoY basis at 82.5mmscmd (82.2mmscmd). However, these volumes declined sequentially by 1.9mmscmd. The decline was primarily due to lower production from PMT field from an average of about 17.3mmscmd to about 15.0mmscmd during the early part of Q4FY09. The average transmission tariff during Q4FY09 increased by 17.6% YoY to Rs784/'000scm as against our expectation of Rs700/'000scm.

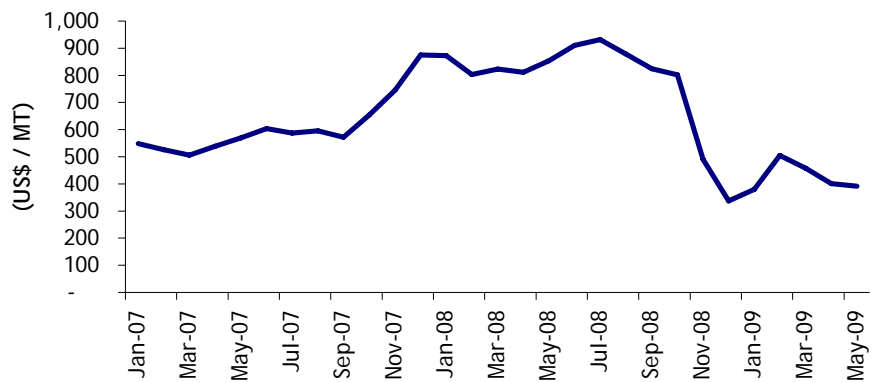
Natural gas trading: Volumes and realisations up

Natural gas trading volumes declined sequentially from 80.0mmscmd to 77.4mmscmd in Q4FY09 owing to a decline in the production from PMT field. However, realisations remained buoyant at Rs5.7/scm (Rs4.4/scm).

LPG and liquid hydrocarbons: Good realisations with no subsidy burden

GAIL did not share any subsidy burden during Q4FY09, which improved the performance of LPG and liquid hydrocarbons segment. Average realisations in Q4FY09 were at about US\$445/MT compared to about US\$193/MT in Q3FY09. The LPG and liquid hydrocarbons segment, thus, reported an operating profit of Rs2.46bn as against a loss of Rs2.26bn in Q3FY09 (due to subsidy burden of Rs9.0bn).

Global LPG prices



Source: Bloomberg, PL Research
 Q4FY09 average LPG Price-US\$455/Tonne,
 Q4FY08 average LPG Price-US\$812/Tonne

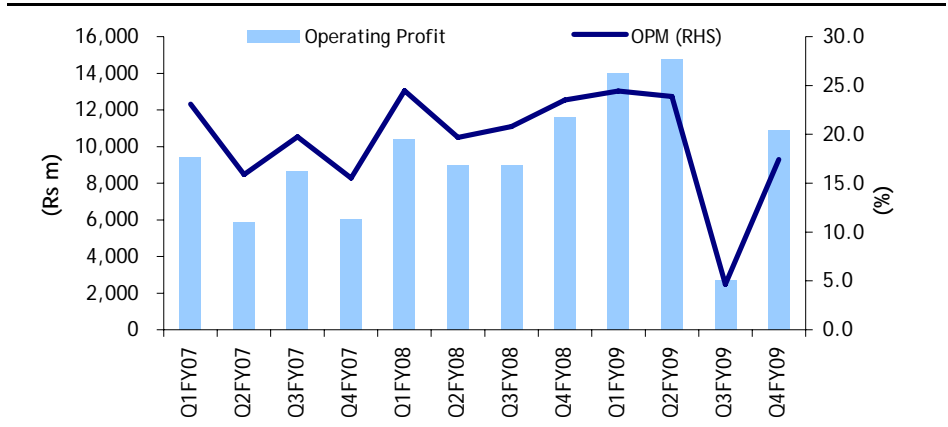
Petchem: Volumes down, realisations surge

Petchem volumes were down 20.0% sequentially to 104,000 tonnes from 130,000 tonnes in Q3FY09. Volumes were abnormally higher in Q3FY09 as the quarter had a spill over effect of Q2FY09. The positive surprise was that the petchem realisations jumped by over 38% sequentially to Rs65,288/ton (about US\$1,287/ton) from Rs47,154/ton (about US\$966/ton). Globally petchem prices were on an upsurge during the quarter which helped the Indian petchem companies earn good realisations. The petchem outlook seems to have improved which will help GAIL during FY10 as incremental realisations directly trickle down to the operating margins as GAIL's feedstock cost is fixed.

EBITDA margins: Higher other expenditure draws down the EBITDA margins

GAIL's staff cost declined by 77.6% YoY to Rs0.49bn (Rs2.20bn) owing to higher provisioning in the earlier quarters. However, the company wrote off Rs1.26bn on account of dry well expenditure in E&P business which affected the EBITDA margins. The EBITDA margins, thus, declined by 610bps to 17.4% (23.5%). However, sequentially the EBITDA margins surged by a whopping 1,280bps on account of higher petchem realisations and no subsidy burden.

Operating performance



Source: Company Data, PL Research



GAIL FY09 Consolidated performance

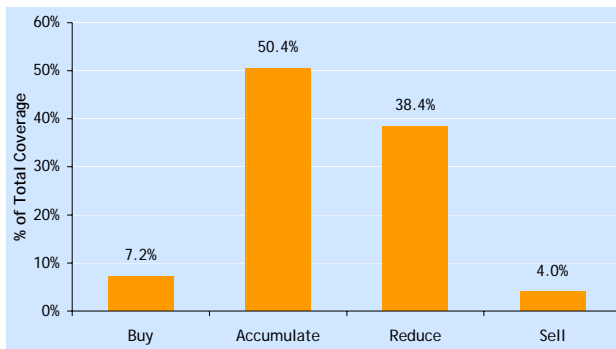
GAIL consummated revenues in FY09 jumped by 36.0% YoY to Rs246bn (Rs181bn) on account of higher petchem realisations and jump in natural gas trading business. EBITDA margins, however, declined by 430bps to 18.5% (22.8%) owing to higher subsidy sharing during the year, coupled with higher staff costs. Consolidated PAT during FY09 increased marginally by 1.0% YoY to Rs27.9bn (Rs27.6bn).

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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