

Gas Authority of India Limited

Steady 2QFY12

GAIL reported 2Q profits of Rs10.9bn (up 19% y/y; 11% q/q) slightly ahead of our and street estimates, with better than expected performance from the petrochemical and LPG segments. Gas volumes were marginally higher.

- **Gas transmission volumes stable, margins lower:** Gas transmission volumes were stable q/q, at 119mmscmd. However, gas transmission EBITDA was 10% lower sequentially. Gas trading volumes were also stable, at 84mmscmd, with a similar 8% sequential drop in EBITDA. GAIL brought in 4 LNG cargos during the quarter, and expects to bring in a similar number for the December quarter as well.
- **Petrochemicals stages smart recovery:** Petchem volumes were at 129KMT for the quarter (up 47% q/q), with petchem EBITDA rising 56%. EBITDA/MT rose to ~\$757 (from \$726).
- **LPG benefits from lower subsidy:** LPG contribution rose with a lower sequential subsidy, with EBITDA rising 49% sequentially.
- **Subsidy as expected:** Subsidies came in at Rs5.6 bn. The upstream sector has borne ~33% of subsidies for the quarter.
- **Project update:** The Dabhol LNG terminal is expected to be commissioned in the March quarter. GAIL continues to work on the expansion of its pipeline network, and expects to exit FY12 with a nameplate capacity of ~220mmscmd.
- **Retain rating, estimates:** Our estimates are subject to review following further analysis and inputs from GAIL management conference call in the coming days. As such, we retain our Overweight rating, and Mar-12 price target of Rs535.

Overweight

GAIL.BO, GAIL IN

Price: Rs425.70

Price Target: Rs535.00

India

India Oil, Gas and Petrochemicals

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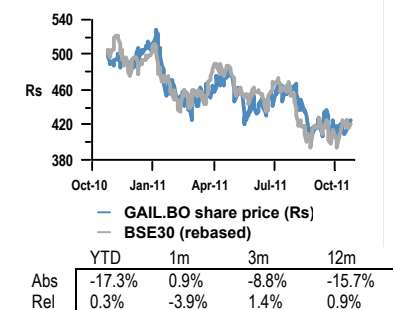
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J.P. Morgan India Private Limited

Price Performance



Gas Authority of India Limited (Reuters: GAIL.BO, Bloomberg: GAIL IN)

Rs in mn, year-end Mar	FY10A	FY11A	FY12E	FY13E	FY14E
Revenue (Rs mn)	251,033	325,365	463,032	522,498	611,600
EBITDA (Rs mn)	47,760	55,324	56,499	66,831	82,758
Net Profit (Rs mn)	33,174	35,611	36,688	40,043	46,916
EPS (Rs)	26.15	28.07	28.92	31.57	36.99
DPS (Rs)	9.16	10.39	10.70	11.68	13.68
Revenue growth (%)	5.6%	29.6%	42.3%	12.8%	17.1%
EPS growth (%)	18.3%	7.4%	3.0%	9.1%	17.2%
ROCE	24.6%	24.5%	19.0%	17.3%	17.5%
ROE	21.0%	19.8%	18.1%	17.8%	18.7%
P/E	16.3	15.2	14.7	13.5	11.5
P/BV	3.2	2.8	2.5	2.3	2.0
EV/EBITDA	10.8	9.8	10.2	9.5	8.1
Dividend Yield	2.2%	2.4%	2.5%	2.7%	3.2%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

Shares O/S (mn)	1,268
Market Cap (Rs mn)	539,991
Market Cap (\$ mn)	10,794
Price (Rs)	425.70
Date Of Price	24 Oct 11
Free float (%)	27.7%
3-mth trading value (Rs mn)	661.24
3-mth trading value (\$ mn)	13.22
3-mth trading volume (mn)	2.72
BSE30	16,786
Exchange Rate	50.03
Fiscal Year End	Mar

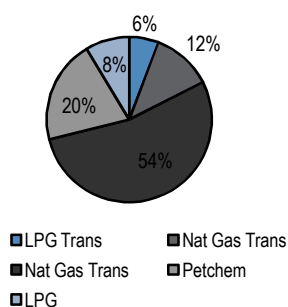
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Company Description

GAIL Limited is India's largest natural gas transmission company with 7,000km of natural gas and 80% market share in India's natural gas Transmission. GAIL has diversified into petrochemicals with 410Kmta of PE capacity and has 1,2mmtpa LPG extraction capacity. With increasing gas supplies from RIL's KG basin and additional LNG, GAIL should be a major beneficiary with majority of the gas being transmitted through GAIL's network. We see this as a primary earnings driver for GAIL over FY11-15E.

Revenue customer chart



Source: Company, J.P.Morgan estimates

EPS: J.P. Morgan vs consensus

Rs	J. P. Morgan	Consensus
FY12E	28.9	31.4
FY13E	31.6	33.9

Source: Bloomberg, J.P.Morgan estimates

P&L sensitivity metrics (FY12)

	EBITDA impact (%)	EPS impact (%)
Transmission Volume Impact		
Impact of each 5mmsmcd volumes	7.7%	9.0%
Higher subsidy		
Impact of 7% share in upstream	-14.9%	-17.4%
Petchem margin impact		
Impact of 10% lower margins	-5.4%	-6.3%

Source: J.P.Morgan estimates

Price target and valuation analysis

Our Mar-12 PT is at Rs 535/share based on DCF (including Rs77/share for investments). The DCF estimate assumes 8% intermediate growth from FY16-FY20 and 3% terminal growth from FY21 onwards with explicit estimates capturing gas volume increases till FY15. We assume a beta of 0.8, risk-free rate of 8.0%, market risk premium of 6.0%, and cost of debt of 9.0% to arrive at a WACC of 10.4%.

Risk free rate:	8%
Market risk premium:	6%
Beta:	0.8
Debt/equity:	35%
Cost of debt:	9%
Terminal "g":	3%

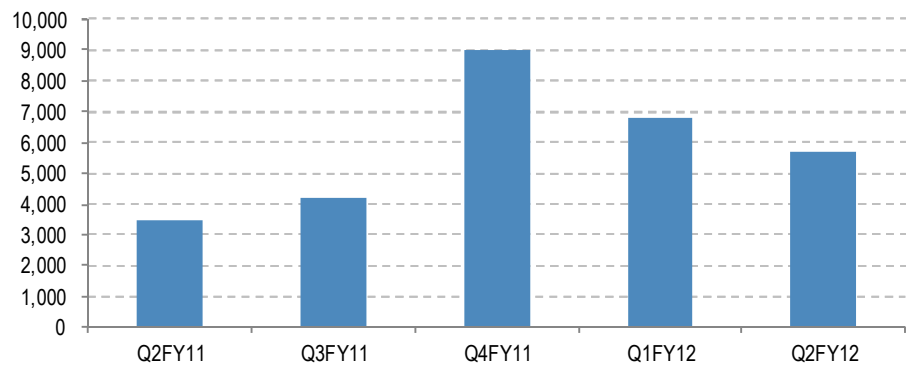
Our PT implies a FY12E P/E of 18.5x, higher than the historical range. We believe an easing of pipeline constraints, coupled with favourable pricing will drive 14% earnings CAGR over FY10-15E. Key downside risks are higher than expected subsidy share and lower than forecast gas transmission volumes.

Table 1: GAIL 2QFY12 earnings summary

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	y/y %	q/q %
Net sales	81,282	83,836	89,089	88,890	97,264	20%	9%
Chg in stock	(555)	179	(235)	(1,875)	(912)	64%	-51%
Purchases	55,741	56,863	61,613	62,114	65,926	18%	6%
Raw Mat.	4,938	5,647	5,862	5,788	6,316	28%	9%
Staff costs	1,538	1,604	2,750	1,782	1,779	16%	0%
Other exp.	5,050	6,212	6,221	5,309	7,400	47%	39%
EBITDA	14,570	13,331	12,877	15,772	16,755	15%	6%
Other inc.	1,499	1,906	525	647	1,160	-23%	79%
Interest	117	165	341	208	226	93%	9%
Depreciation	1,626	1,605	1,672	1,782	2,008	23%	13%
PBT	14,326	13,467	11,389	14,429	15,682	9%	9%
Tax	5,090	3,791	3,558	4,582	4,738	-7%	3%
Net profit	9,236	9,676	7,831	9,847	10,944	19%	11%

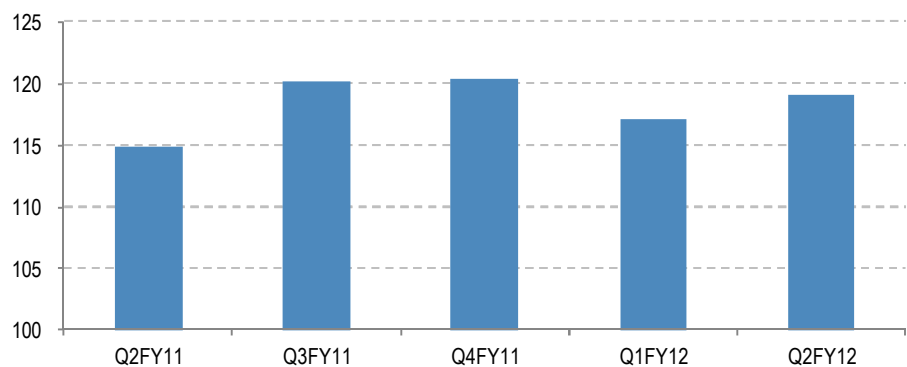
Source: Company reports.

Figure 1: GAIL subsidy payout (Rs mn)



Source: Company reports.

Figure 2: GAIL gas transmission volumes (mmscmd)



Source: Company reports.

Gas Authority of India Limited: Summary of Financials

Income Statement						Cash flow statement					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E
Revenues	251,033	325,365	463,032	522,498	611,600	EBIT	42,142	48,822	46,296	53,569	66,351
% change Y/Y	5.6%	29.6%	42.3%	12.8%	17.1%	Depr. & amortization	5,618	6,503	10,203	13,262	16,406
Gross Margin	-	-	-	-	-	Change in working capital	14,628	-10,372	30,366	176	4,157
EBITDA	47,760	55,324	56,499	66,831	82,758	Taxes	-	-	-	-	-
% change Y/Y	17.8%	15.8%	2.1%	18.3%	23.8%	Others	-	-	-	-	-
EBITDA Margin	19.0%	17.0%	12.2%	12.8%	13.5%	Cash flow from operations	54,056	34,179	77,257	53,482	67,478
EBIT	42,142	48,822	46,296	53,569	66,351	Capex	-33,379	-46,714	-91,920	-99,270	-82,220
% change Y/Y	20.6%	15.9%	NM	15.7%	23.9%	Disposal/(purchase)	-	-	-	-	-
EBIT Margin	16.8%	15.0%	10.0%	10.3%	10.9%	Free cash flow	17,320	-17,630	-14,663	-45,788	-14,742
Net Interest	5,418	3,578	3,283	-178	-3,797	Equity raised/(repaid)	-	-	-	-	-
Earnings before tax	47,560	52,400	49,579	53,391	62,554	Debt raised/(repaid)	-	-	-	-	-
% change Y/Y	13.1%	10.2%	-5.4%	7.7%	17.2%	Other	-	-	-	-	-
Tax	-14,386	-16,789	-12,891	-13,348	-15,639	Dividends paid	-	-	-	-	-
as % of EBT	30.3%	32.0%	26.0%	25.0%	25.0%	Beginning cash	-	-	-	-	-
Net income (reported)	33,174	35,611	36,688	40,043	46,916	Ending cash	-	-	-	-	-
% change Y/Y	18.3%	7.4%	3.0%	9.1%	17.2%	DPS	9.16	10.39	10.70	11.68	13.68
Shares outstanding	1,268	1,268	1,268	1,268	1,268						
EPS (reported)	26.15	28.07	28.92	31.57	36.99						
% change Y/Y	18.3%	7.4%	3.0%	9.1%	17.2%						
Balance sheet						Ratio Analysis					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E
Cash and cash equivalents	41,715	21,314	26,088	15,910	18,129	EBITDA margin	19.0%	17.0%	12.2%	12.8%	13.5%
Accounts receivable	12,950	19,059	22,798	25,724	30,109	Operating margin	16.8%	15.0%	10.0%	10.3%	10.9%
Inventories	6,317	8,551	15,199	20,007	23,418	Net margin	13.2%	11.0%	7.9%	7.7%	7.7%
Others	76,144	62,538	20,037	20,037	20,038						
Current assets	137,127	111,462	84,122	81,678	91,695	Sales per share growth	5.6%	29.6%	42.3%	12.8%	17.1%
						Sales growth	5.6%	29.6%	42.3%	12.8%	17.1%
LT investments	20,730	25,825	25,825	25,825	25,825	Net profit growth	18.3%	7.4%	3.0%	9.1%	17.2%
Net fixed assets	130,084	182,827	264,544	350,552	416,365	EPS growth	18.3%	7.4%	3.0%	9.1%	17.2%
Total Assets	184,157	231,966	288,092	363,745	427,621	Interest coverage (x)	-	-	-	375.13	21.79
Liabilities						Net debt to total capital	-15.7%	0.9%	13.1%	30.6%	34.0%
Short-term loans	0	0	0	0	0	Net debt to equity	-16.0%	0.9%	14.9%	39.9%	48.9%
Payables	54,483	47,544	67,327	73,967	83,347	Sales/assets	1.41	1.56	1.78	1.60	1.55
Others	49,301	40,605	19,072	20,343	22,917	Assets/equity	1.46	1.44	1.35	1.54	1.62
Total current liabilities	103,784	88,149	86,400	94,310	106,264	ROE	21.0%	19.8%	18.1%	17.8%	18.7%
Long-term debt	14,804	23,100	58,013	110,513	147,263	ROCE	24.6%	24.5%	19.0%	17.3%	17.5%
Other liabilities	13,896	16,332	16,332	16,332	16,332						
Total Liabilities	28,699	39,432	74,345	126,845	163,595						
Shareholders' equity	167,990	192,533	213,747	236,900	264,026						
BVPS	132.43	151.78	168.51	186.76	208.14						

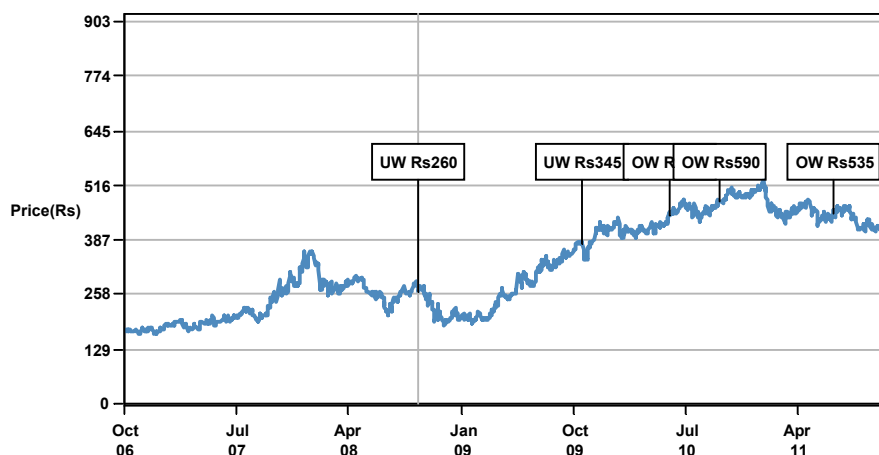
Source: Company reports and J.P. Morgan estimates.

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Gas Authority of India Limited (GAIL.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
18-Sep-08	UW	265.50	260.00
20-Oct-09	UW	377.05	345.00
25-May-10	OW	446.40	510.00
21-Sep-10	OW	480.35	590.00
27-Jun-11	OW	448.30	535.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 18, 2008.

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