In-depth
SECTOR: OIL & GAS

GAIL (India)

Gas authority of India

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Contents

GAIL (India)

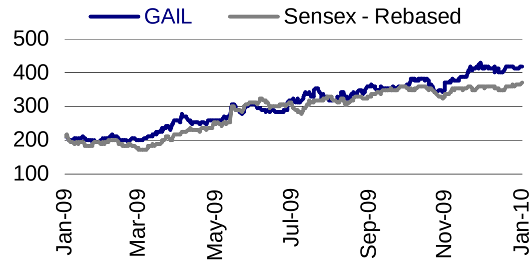
STOCK INFO.	BLOOMBERG
BSE Sensex: 17,686	GAIL IN
	REUTERS CODE
S&P CNX: 5,278	GAIL.BO

Y/E MARCH	2009	2010E	2011E	2012E
Net Sales (Rs b)	237.8	259.3	329.1	371.6
EBITDA (Rs b)	40.5	44.8	57.5	70.9
Net Profit (Rs b)	28.5	28.8	34.7	37.0
EPS (Rs)	22.5	22.7	27.3	29.1
EPS Growth (%)	9.6	0.9	20.4	6.6
BV/Share (Rs)	116.4	132.1	152.4	174.5
P/E (x)	19.0	18.5	15.3	14.4
P/BV (x)	3.6	3.2	2.7	2.4
EV / EBITDA (x)	8.8	9.1	8.0	7.9
EV / Sales (x)	1.8	1.8	1.5	1.6
RoE (%)	19.0	17.2	17.9	16.7
RoCE (%)	24.8	22.0	20.7	16.1

KEY FINANCIALS	
Shares Outstanding (m)	1,268.5
Market Cap. (Rs b)	531.5
Market Cap. (US$ b)	11.5
Past 3 yrs Sales Growth (%)	18.0
Past 3 yrs NP Growth (%)	6.7
Dividend Payout (%)	31.1
Dividend Yield (%)	1.7

STOCK DATA	
52-W High/Low Range (Rs)	432/186
Major Shareholders (as of September 2009)	(%)
Promoters	64.6
Domestic Institutions	17.1
Foreign	15.3
Public/Others	3.0
Average Daily Turnover	
Volume ('000 shares)	2,407.1
Value (Rs million)	693.8
1/6/12 Month Rel. Performance (%)	-2/5/24
1/6/12 Month Abs. Performance (%)	1/33/96

STOCK PERFORMANCE V/S NIFTY (1 YEAR)



6 January 2010

Buy

Previous Recommendation: Buy

Rs416

Re-rating imminent: GAIL is on its way to becoming a true utilities company - gas transmission will account for over 65% by FY14 from 53% in FY09 of its EBIT. Its transmission business has all the characteristics of a utilities company: (1) Large asset base with annuity-like returns, (2) Secular demand growth with strong long-term earnings visibility, and (3) Direct customer interface with CGD business. We believe that GAIL should trade at par with other utilities companies.

Geared to capture huge gas transmission opportunity: India is witnessing a big thrust in gas production from domestic finds in the Krishna-Godavari basin. We expect gas availability in India to grow at 23% CAGR to 312mmscmd by FY14, buoyed by trebling of domestic production to 254mmscmd and doubling of RLNG imports to 58mmscmd. To capture the huge transmission opportunity presented by this gas surge, GAIL is investing to double its capacity by FY12/13. We expect its transmission volumes to grow at 20% CAGR through FY14 to 208mmscmd.

HVJ-DVPL tariffs to stay intact, 10% upside likely: As against consensus expectations of tariff decline for its HVJ-DVPL network (which accounts for >65% of its total volumes), our calculations indicate that tariffs should stay intact or even increase by 10%.We expect GAIL's profits (EBIT) from the transmission business to increase 2.8x by FY14.

CGD and E&P to add substantial value, petchem capacity to double by FY12: GAIL is expanding its CGD presence from the current 9 cities to 45-50 cities in the next 4-5 years, with a gas volume potential of 25mmscmd. We believe CGD would lead to long-term value creation for GAIL and just 25mmscmd volumes would add Rs27/ share. Further value accretion would come from its E&P blocks entering production phase and doubling of petchem capacity by FY12.

Increasing FY11E EPS, upgrading target price; Buy: We remain positive on GAIL primarily due to: (1) long-term revenue visibility, (2) value creation through the CGD business, (3) potential upside from its E&P business, and (4) likely favorable policy decision on subsidy. We value GAIL on SOTP basis at Rs485 (core business at 14x FY12E EPS), investment value of Rs54/share and E&P value of Rs23/share). We believe there is further upside potential of at least Rs27/share from its CGD foray. Adjusted for investments, the stock trades at 11.7x FY12E EPS of Rs29.1. We maintain **Buy**.

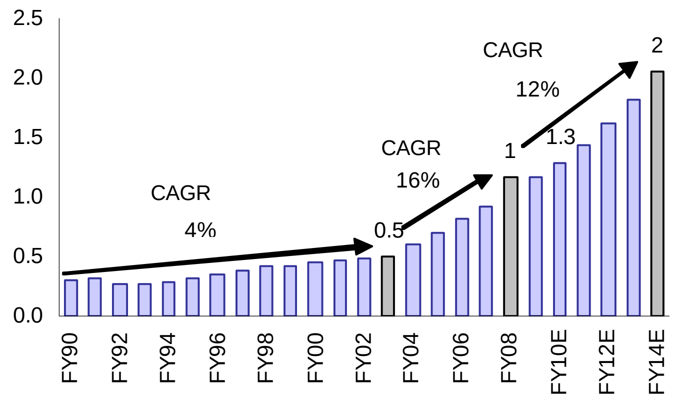
Prologue

In mid-December, we released our theme report titled "Winner Categories, Category Winners". We covered 4 fundamental points in that report and GAIL qualifies on all fronts.

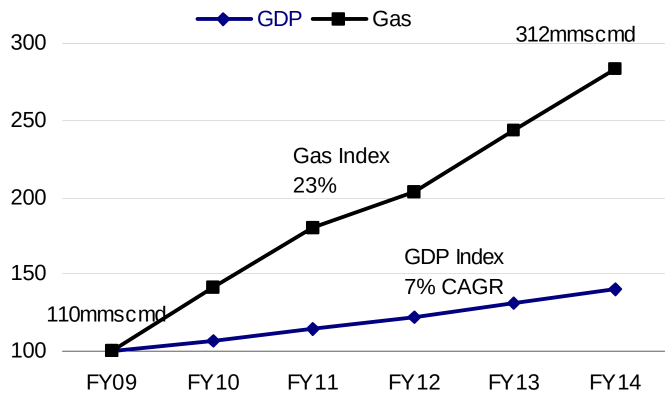
1. **India's NTD Era:** After taking over 60 years to reach its first US$1 trillion of GDP, India will achieve the next trillion dollar (NTD) in 6 years i.e. nominal growth of 12.4% (7% real + 5% inflation). This NTD Era will see several businesses (or categories) growing significantly faster than GDP growth.

2. **Winner Categories:** We define Winner Category as one which (1) Will grow at least 1.5x GDP growth i.e. over 18%; and (2) Is fairly consolidated in character i.e. limited number of players to share the benefits of growth. We are convinced that in India's NTD Era, Gas Transmission/Distribution is one such Winner Category.

INDIA'S GDP (US$T)



GAS AVAILABILITY GROWTH V/S GDP GROWTH



Source: Company/Bloomberg/MOSL

3. **Category Winners:** A Category Winner is a company which (1) Emerges from a Winner Category, (2) Has strong entry barriers, and (3) Has a great management, defined as one which defends the entry barriers, and maintains growth at least at the category rate.

GAIL qualifies on all these fronts:

(1) GAIL is by far the largest player in India's Gas Transmission/Distribution category;

(2) GAIL is a natural monopoly; its large pipeline network is a strong entry barrier, which cannot be replicated ever in India.

(3) GAIL management's aggressive capex plans convince us that it will match both the required criteria of "greatness" i.e. defending entry barrier and growing at least at category rate.

4. **Winning Investments:** Category Winners bought at reasonable valuation prove to be winning investments. Adjusted for listed investments and subsidy, GAIL is trading at a reasonable valuation of less than 8x EV/EBITDA FY11E.

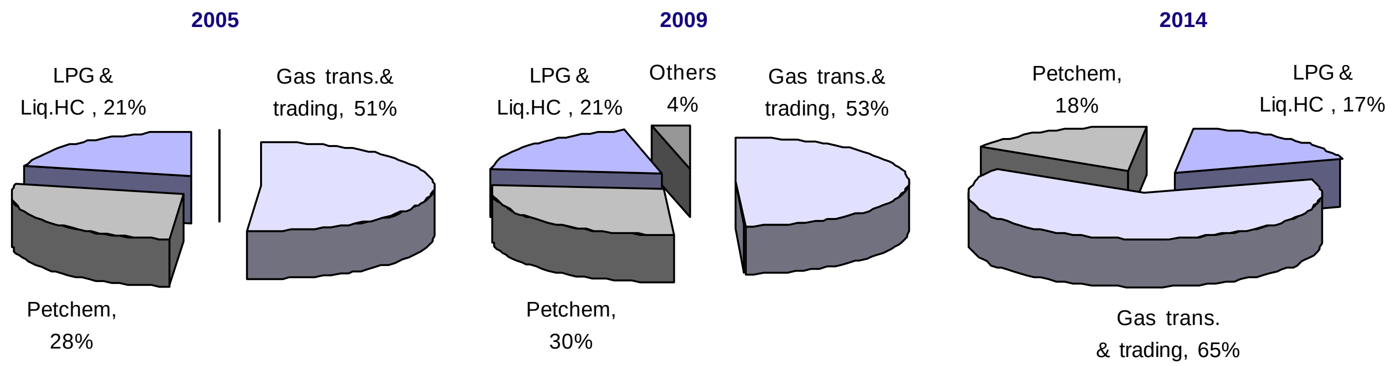
We recommend GAIL as a winning investment in India's NTD Era.

Re-rating imminent

By FY14, GAIL's transmission business would account for over 65% of its EBIT

GAIL is on its way to becoming a true utilities company. We expect its transmission volumes to grow at a CAGR of 20% over FY09-14, led by 23% CAGR in domestic gas availability. As GAIL's transmission volumes grow from 110mmscmd to 208mmscmd by FY14, the contribution of its transmission business to overall EBIT would increase from 53% in FY09 to ~65% in FY14.

TRANSMISSION BUSINESS TO ACCOUNT FOR >65% OF EBIT



Source: Company/MOSL

Its transmission business has all the characteristics of a utilities company

GAIL's gas transmission business has all the characteristics of a utilities company:
(1) Large asset base with annuity-like returns
(2) Secular demand growth with strong long-term earnings visibility
(3) Direct customer interface with CGD business

Indian utility companies are trading at FY12 P/E multiples of 15.7x as against 11.7x (adjusted for investment) for GAIL.

Utilities companies in India command higher valuations than GAIL

COMPARATIVE VALUATIONS

	MCAP	ROE	P/E (X)		EV/EBITDA (X)	
	(US$B)	(%)	FY11E	FY12E	FY11E	FY12E
CESC	53	9	13.9	10.5	8.1	6.9
NTPC	1,896	15	19.2	17.0	14.1	11.7
REL	14	10	19.1	19.0	18.1	14.8
Tata Power	334	16	17.6	16.2	10.1	8.8
Average	**574**	**12**	**17.5**	**15.7**	**12.6**	**10.6**
GAIL	**532**	**17.2**	**12.5**	**11.7**	**8.0**	**7.9**

Source: Company/MOSL

Geared to capture huge gas transmission opportunity

India is witnessing a big thrust in gas production from domestic finds in the Krishna-Godavari basin. We expect gas availability in India to increase ~2.8x to 312mmscmd by FY14, buoyed by trebling of domestic production to 254mmscmd and doubling of RLNG imports to 58mmscmd. To capture the huge transmission opportunity presented by this gas surge, GAIL is investing to double its capacity by FY12/13. We expect its transmission volumes to grow at 20% CAGR through FY14 to 208mmscmd.

Gas availability in India to treble by FY14

We expect gas availability in India to treble by FY14…

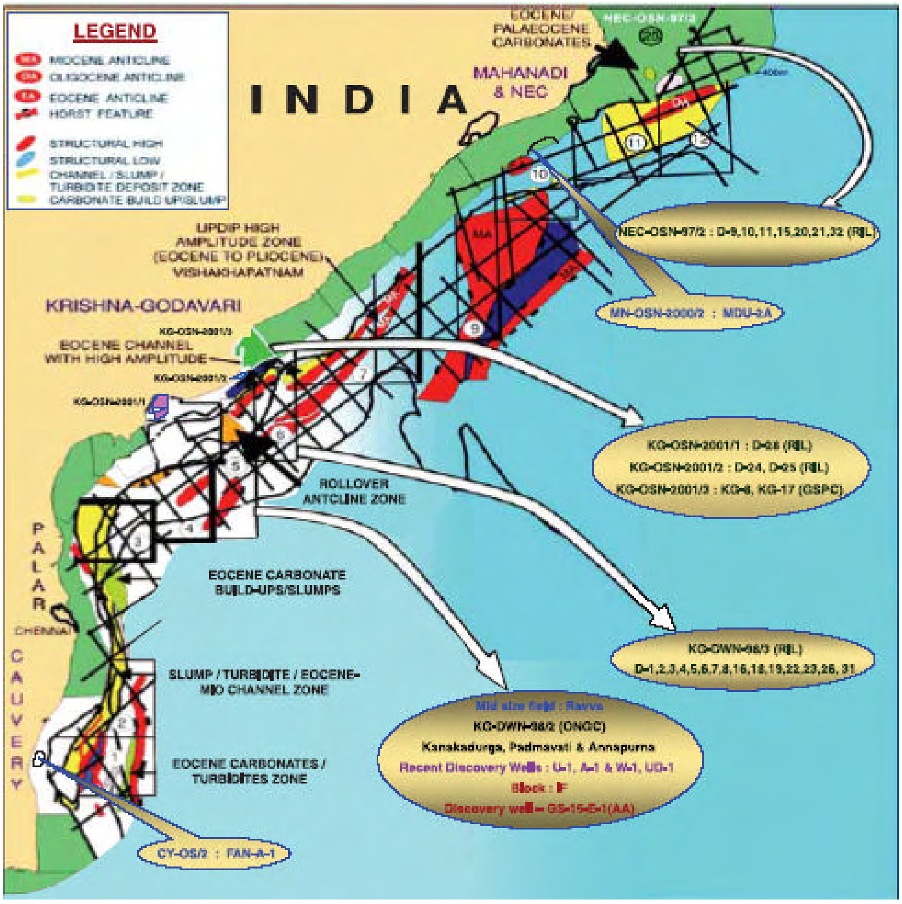
We expect India's domestic gas production to treble from 78mmscmd in FY09 to 254mmscmd in FY14. Near-term increase in gas supply would come from (1) RIL's KG-D6 block (currently 50mmscmd; 80mmscmd by March 2010), and (2) RLNG imports (capacity expansion from 20mmscmd to 30mmscmd at PLL's Dahej terminal).

Over the long term, increase in gas supply would come from (1) RIL's KG-D6 reaching 120mmscmd in FY14, (2) GSPC's KG block producing 15mmscmd in FY13, (3) RIL's NEC-25 producing 10mmscmd in FY13, (4) ONGC's KG block producing 25mmscmd in FY14 and (5) RLNG imports increasing to 58mmscmd.

…buoyed by surge in both domestic gas production…

India's east coast is now recognized as a world-scale gas province and we believe there would be further gas discoveries, leading to large gas availability in the long term.

HUGE GAS PRODUCTION POTENTIAL FROM EAST COAST IN INDIA



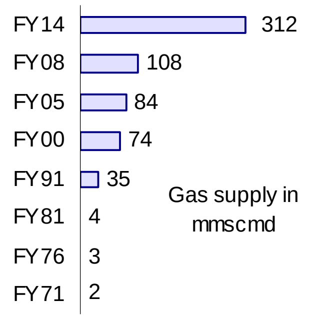
Source: DGH/MOSL

Despite the anticipated surge in domestic gas production, we believe India will continue to remain gas-deficient. RLNG imports are the only option available to India (trans-national pipelines would remain a mirage). We expect RLNG imports to double to 58mmscmd by FY14.

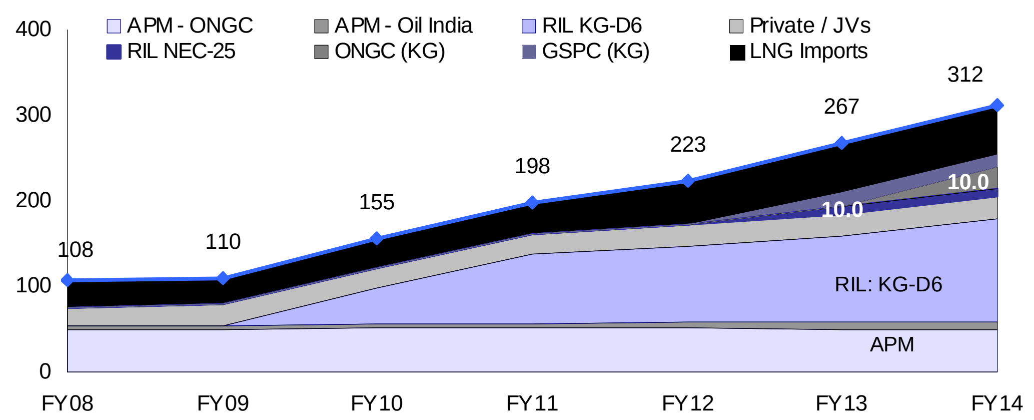
…and RLNG imports

Petronet LNG has recently announced the completion of revamp of its LNG Terminal at Dahej, increasing its capacity from 5mmtpa to 10mmtpa. Its 2.5mtpa Kochi terminal is likely to commission by FY12. The other LNG terminal operator, Shell (2.5mmtpa capacity) has been a passive LNG supplier to India. However with global LNG supply pressure easing and addition of large LNG capacities, Shell too would look for a larger pie of the India opportunity.

FY08-14: GAME CHANGING ERA



DOMESTIC GAS AVAILABILITY TO TREBLE BY FY14 (MMSCMD)



Source: Industry/Infraline/MOSL

Gas demand to remain higher than supply

Indian gas markets have been supply constrained. The demand-supply gap has continually widened with ever increasing demand for gas. As against the current estimated demand of 226mmscmd, current supply is only 155mmscmd, implying a 31% deficit.

Several industry/government estimates are available for likely gas demand in the medium to long term. Gas demand estimates for 2012 range from a low of 181mmscmd to a high of 373mmscmd. For a longer term, the variation is even higher. The gas demand forecasts for 2030 range from 326mmscmd to 1,110mmscmd. The large variation in estimates is understandable, as the future demand growth is linked to several key variables such as supply visibility, gas pricing, regulatory environment, development of gas networks, downstream industry, alternate fuel economics, etc.

However, gas demand would remain higher than supply for the foreseeable future

The key feature to note, however, is that all estimates point to increasing trend of gas demand. With increasing visibility on gas supplies, pricing, regulation, etc, we believe that gas demand would continue to increase and would remain higher than gas supplies, at least in the foreseeable future.

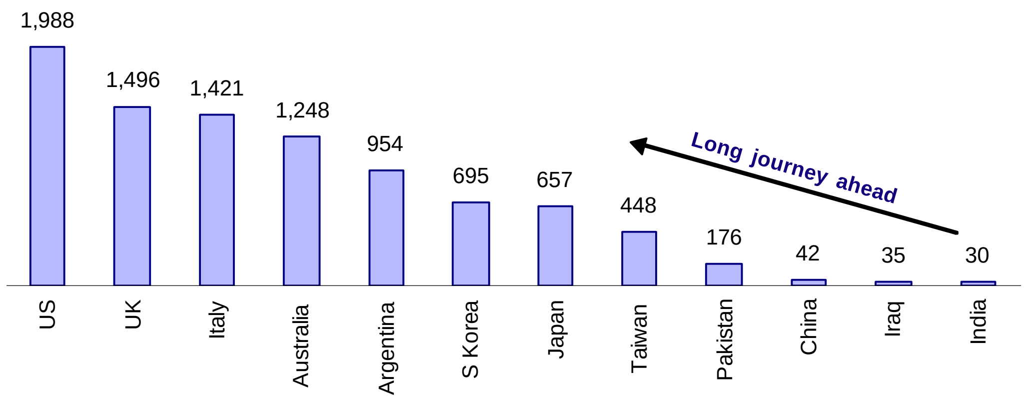
India far behind in natural gas consumption - poised to catch up

Historically, India has been a gas-deprived country, with gas contributing hardly 9% of the total energy mix. With large domestic finds and commissioning of global LNG capacities, we expect the pressure on gas supply to diminish. As a result, gas consumption would rise.

The per capita gas consumption in India is miniscule

The per capita gas consumption in India is 34scm - minuscule as compared to 2,000scm in the US. Even Pakistan consumes more than 150scm per capita. We expect multi-fold increase in India's total per capita energy consumption and a significant improvement in the share of gas in its energy basket.

INDIA'S NATURAL GAS CONSUMPTION PER CAPITA (SCM) AS ON MARCH 2009 - LONG WAY TO CATCH UP



Source: Industry/MOSL

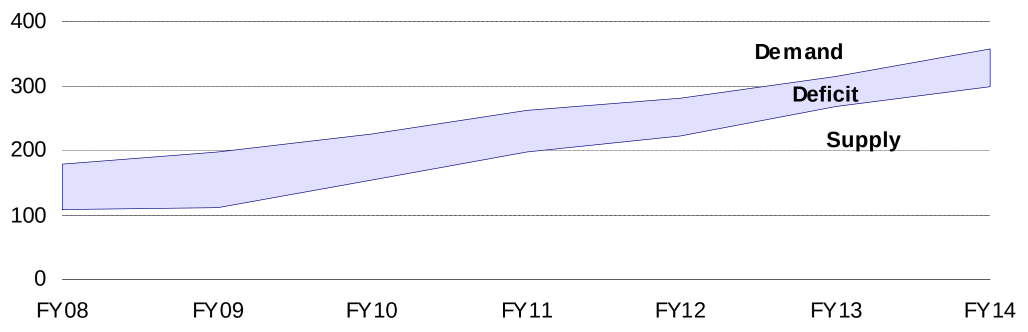
We expect multifold increase in India's gas consumption with increasing supply

THOUGH LOWER THAN CURRENT, GAS DEFICIT TO CONTINUE

MMSCMD	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Domestic Supplies							
APM - ONGC	48	48	50	51	51	50	50
APM - OIL	5	5	5	6	7	9	9
RIL KG-D6			41	80	89	100	120
Private / JVs	21	25	25	25	25	25	25
RIL NEC-25						10	10
GSPC (KG)						15	15
ONGC (KG)							25
Domestic Supply	**74**	**78**	**122**	**162**	**173**	**209**	**254**
LNG Imports	33	32	33	36	50	58	58
Total Supply	**108**	**110**	**155**	**198**	**223**	**267**	**312**
Domestic Demand							
Power	80	91	103	114	127	146	167
Fertilizer	41	43	56	76	76	81	89
City Gas	12	13	14	15	16	20	25
Industrial	15	16	17	18	20	22	24
Petchem/Refining	25	27	29	31	33	37	40
Sponge iron / Steel	6	6	7	7	8	9	10
Total Demand	**179**	**197**	**226**	**262**	**279**	**313**	**356**
Surplus/(deficit)	**(72)**	**(87)**	**(71)**	**(64)**	**(57)**	**(47)**	**(44)**

Source: Industry/Infraline/MOSL

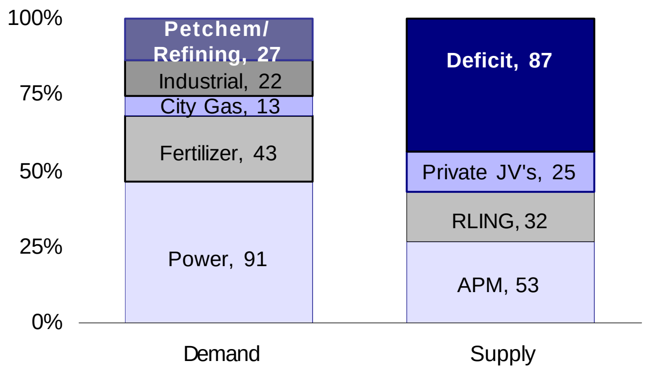
LIKELY DEMAND-SUPPLY GAP (MMSCMD)



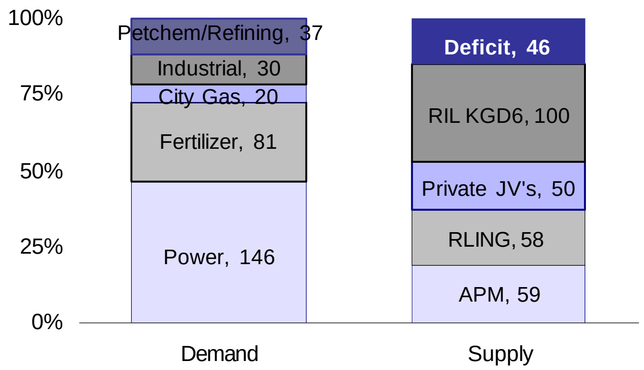
Source: Industry/Infraline/MOSL

BREAK-UP OF GAS DEMAND AND SUPPLY IN MMSCMD

FY09



FY14



Source: Industry/Infraline/MOSL

GAIL doubling transmission capacity

To capture the opportunity presented by the impending gas surge in India…

To capture the opportunity presented by the impending gas surge in India, GAIL is investing significantly in its pipeline network. Over then next three years, it will invest Rs30b-35b, expanding its transmission capacity from the current 150mmscmd to 300mmscmd. Through this expansion, GAIL is also spreading its arms to new territories in India, which should further aid growth in transmission volumes.

Its major pipeline projects include (1) Upgradation/extension of HVJ-GREP network, (2) Jagdishpur-Haldia pipeline, (3) Dabhol-Bangalore pipeline, and (4) Kochi-Mangalore-Bangalore pipeline. It plans to commission HVJ-GREP upgradation/expansion in phases starting from December 2009 to end-2011. The three new cross-country pipelines are likely to be completed only in FY13.

The capacity augmentation of HVJ-DVPL pipeline is underway. The expansion on the trunkline by laying the Bawana-Nangal pipeline, the Chainsa-Jajjar-Hissar pipeline, and the addition of compressors at its various stations would increase the total HVJ-DVPL network capacity to 78mmscmd.

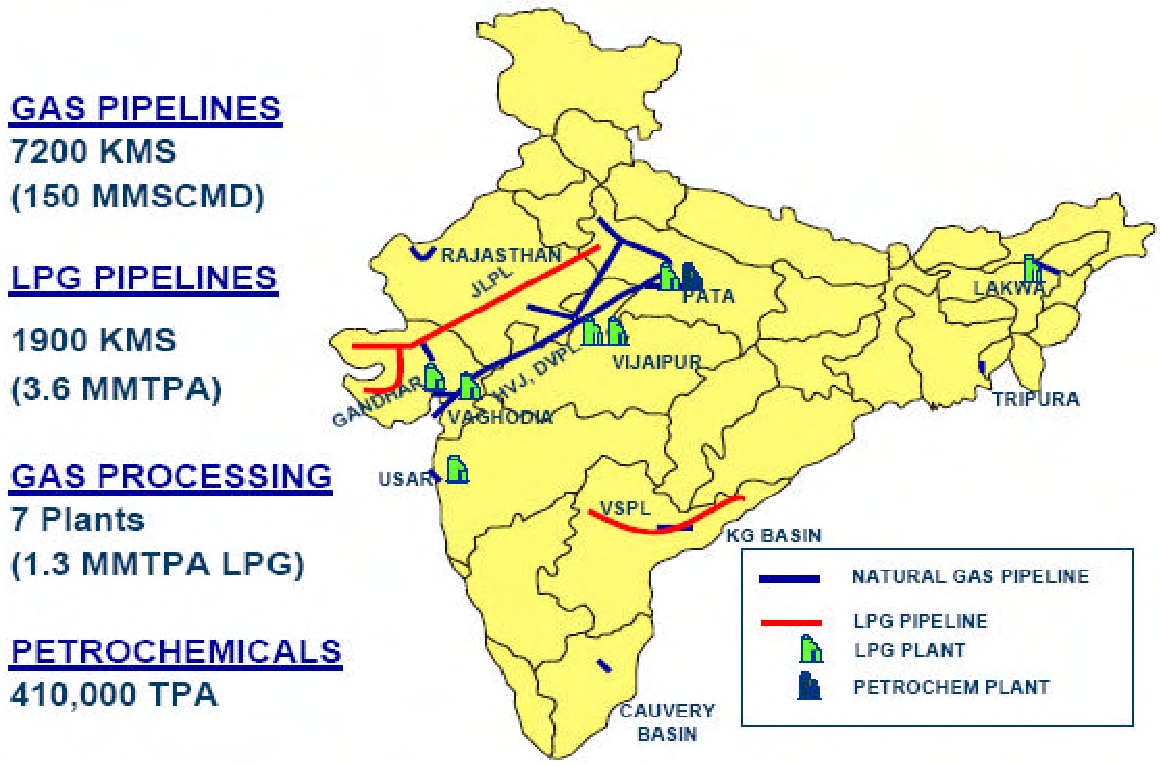
…GAIL intends to double its transmission capacity in the next three years

GAIL: CURRENT AND PLANNED PIPELINES

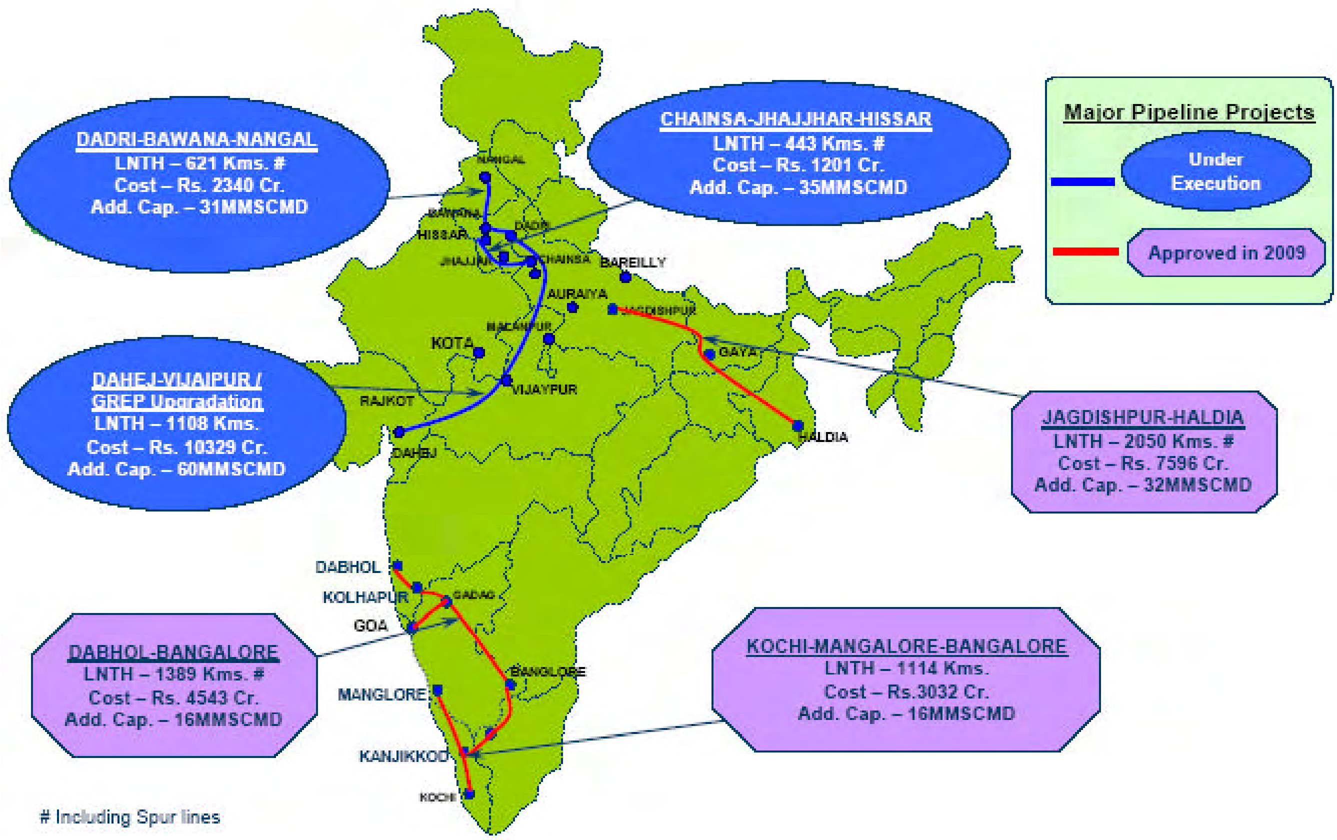
PIPELINE	LENGTH (KM)	CAPACITY (MMSCMD)
HVJ-DVPL System		
HVJ/GREP	3,187	33
DVPL/DPPL/DPPL	612	24
Others		
DUPL-DPPL	796	12
Gujarat & Rajasthan	743	20
Mumbai	125	36
KG Basin	833	16
Cauveri	260	9
Tripura	60	2
Assam	8	3
Total	**6,624**	**154**
New Capacity		
Vijaypur-Dadri	498	40
DVPL Phase II	610	21
Dhabol- Bangalore	2,050	16
Kochi - Mangalore - Bangalore	1,114	16
Jagdishpur - Haldia	1,389	32
Total	**12,285**	**279**

Source: Company/MOSL

GAIL: CURRENT NETWORK



PLANNED PIPELINE NETWORK



Source: Company/MOSL

Gas Utilization Policy favorable to GAIL

Given that the Gas Utilization Policy is also favorable to GAIL…

The gas market in India is at a nascent stage and is currently regulated by the government. End-consumers are allocated gas through the Gas Utilization Policy under the aegis of Empowered Group of Ministers (EGoM). Under this policy, the initial gas supply is largely directed towards priority sectors like fertilizers, LPG & petrochemicals, power, and CGD networks. With most of these priority consumers on GAIL's existing network (in HVJ or KG basin area), a large portion of RIL's gas would go through GAIL's network to reach end-consumers.

GAIL TO BE LARGEST BENEFICIARY OF KG-D6 GAS UTILIZATION POLICY (MMSCMD)

SECTOR	INITIAL ALLOCATION	FOLLOW-ON ALLOCATION FIRM	FALLBACK	SUB-TOTAL	TOTAL
Power	18.0	13.2	12.0	25.2	43.2
Captive Power		0.0	10.0	10.0	10.0
Fertilizer	15.3	0.2	0.0	0.2	15.5
City Gas Distribution	0.8	0.0	2.0	2.0	2.8
LPG	3.0	0.0	0.0	0.0	3.0
Petrochemical		1.9	0.0	1.9	1.9
Steel (as feedstock)	3.8	0.4	0.0	0.4	4.2
Oil Refineries		5.0	6.0	11.0	11.0
Total	**40.9**	**20.7**	**30.0**	**50.7**	**91.6**

Expected to receive at least 20-25 of the new allocation

GAIL received ~25 of the initial 41mmscmd

Source: Company/MoPNG/MOSL

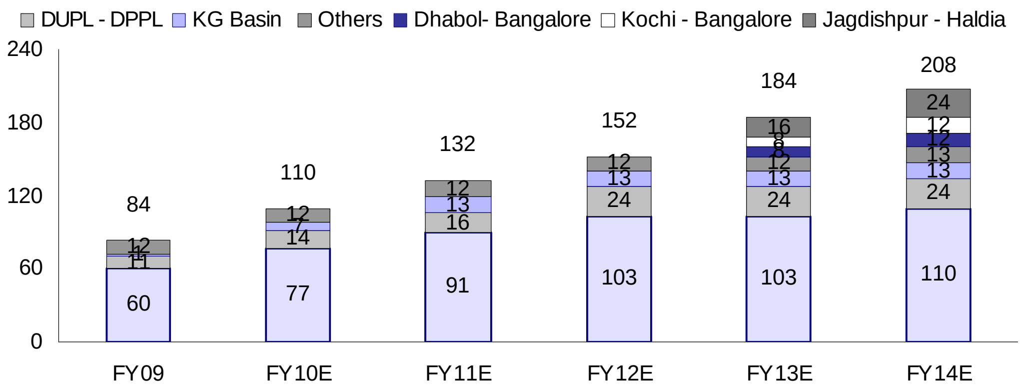
Expect GAIL's transmission volumes to double by FY14

…we expect its transmission volumes to double by FY14

As witnessed during the last nine months (volumes increased 33%), GAIL is already benefiting from the new gas supplies from RIL's KG-D6 block (current transmission volume of 110mmscmd v/s 83mmscmd in March 2009). Of the initial 40mmscmd gas volumes from KG-D6, it is transporting 27mmscmd (67%).

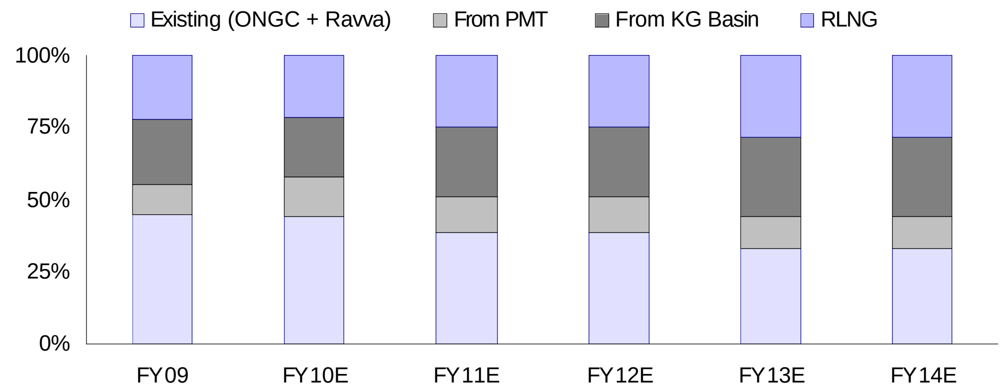
After much delayed allocation of additional 40mmscmd of KG-D6 gas, the government has nominated the customers for the additional gas. With this allocation, production from KG-D6 is expected to reach 80mmscmd by March 2010. GAIL's management is confident of receiving 20-25mmscmd of the additional 40mmscmd gas from KG-D6.

GAIL: TRANSMISSION VOLUME BUILD-UP (MMSCMD)



Source: Company/Infraline/Industry/MOSL

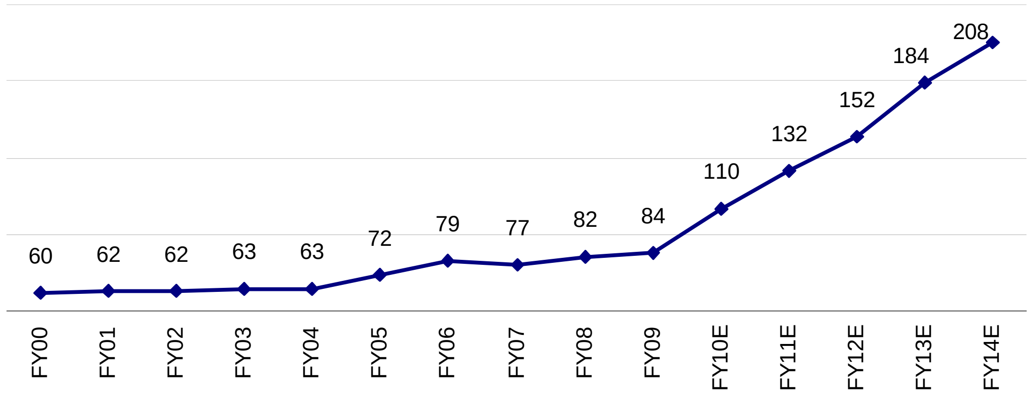
GAIL: KG BASIN GAS TO REPLACE APM GAS AS HIGHEST SHARE IN TRANSMISSION



Source: Company/Infraline/Industry/MOSL

We expect GAIL's transmission volumes to grow from 83mmscmd in FY09 to 208mmscmd by FY14 (22% CAGR - 128mmscmd in FY11, 152mmscmd in FY12 and 184mmscmd in FY13). We see upside risks to our FY11 volume assumptions from additional gas availability from KG-D6.

GAIL: TRANSMISSION VOLUMES TO DOUBLE BY FY14 (MMSCMD)



Source: Company/MOSL

Despite increasing utilization, GAIL will have spare capacity, providing flexibility

Internationally, transmission pipelines have 25-45% capacity excess over gas supplies and the ratio is maintained to retain flexibility. Historically, GAIL's network utilization has remained low (55% in FY09); however, this was not by choice but by compulsion due to lower gas availability. For new pipelines, GAIL's management has a choice to keep the pipeline spare capacity (common carrier) at 25%, which we believe offers useful operational flexibility for GAIL.

HVJ-DVPL tariffs to stay intact, 10% upside likely

GAIL has filed for tariff determination of its existing as well as new pipelines with the regulator, PNGRB, which is likely to respond by January 2010. As against consensus expectations of tariff decline for its HVJ-DVPL network (which accounts for >65% of its total volumes), our calculations indicate that tariffs should stay intact or even increase by at least 10%. We expect GAIL's profits (EBIT) from the gas transmission business to increase 2.8x by FY14.

Against consensus of tariff reduction by 10-15%, we expect HVJ-DVPL tariffs to stay intact

Gas transmission tariffs to be revised; new tariffs likely by January 2010

Tariffs for all existing as well as new pipelines would be set by the regulator, Petroleum and Natural Gas Regulatory Board (PNGRB). GAIL has submitted the revised tariff documents for its HVJ-DVPL network (as a whole) and DUPL-DPPL network to PNGRB, whose approval is expected in January 2010. PNGRB has proposed tariff calculations using the discounted cash flow method (DCF) and post-tax RoCE of 12%.

The consensus estimate factors in a decline in HVJ-DVPL tariff. However, our calculations show that the tariff should increase by at least 10% due to increase in the recent and planned capex.

According to GAIL's management, PNGRB will combine the HVJ-DVPL pipeline with new expansions on the line and spur lines into a single network. A postalized tariff will be computed for this network based on the fixed assets of the network and the planned capex. The net fixed assets (NFA), for HVJ-DVPL network considered by the Tariff Commission were Rs36b. Further, GAIL is incurring a capex of Rs117b on the HVJ-DVPL network, which will be considered in the tariff determination.

Though tariffs could be revised 10-20% for HVJ-DVPL, we factor in no increase in our estimates

We estimate that the revised tariff for HVJ-DVPL would be Rs1,175/mscm (earlier Rs975/mscm). However, in our earnings model, we have built in a conservative tariff keeping it same as present. We have built in an NFA of Rs36b till FY09 and Rs117b of future capex for HVJ-DVPL.

CALCULATIONS (HVJ-DVPL TARIFF)

KEY ASSUMPTIONS	VALUE
Capacity (mmscmd)	100
Net Fixed Assets (Rs m)	36
Opex (%)	3
RoCE (pre-tax, %)	18
No of Days	350
Gas Price (Rs/scm)	7.4
Inflation (%)	4

Source: Company/MOSL

SUMMARY OF TARIFF ESTIMATES

Likely Tariff (Rs/mscm)	**1,175**
Present Tariff (Rs/mscm)	**975**
Change in Tariff (%)	21

Source: Company/MOSL

DCF FOR HVJ-DVPL TARIFF CALCULATIONS

YEAR	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E…	…FY34E
Volumes [2]								
Common carrier (mmscmd)		14.1	14.1	14.1	14.1	14.1	25.0	25.0
Contract carrier (mmscmd)		62.0	65.2	68.5	71.7	75.0	75.0	75.0
Total volumes (mmscmd)		76.1	79.3	82.6	85.9	89.1	100.0	100.0
Annual volumes (mmscm)		26,626	27,768	28,910	30,052	31,194	35,000	35,000
Revenue (Rs b)		31.3	32.6	34.0	35.3	36.7	41.1	41.1
NFA		80.7	111.7	130.9	138.9	146.9		
Opex (Rs b)		2.2	3.0	3.5	3.8	4.0	4.1	8.7
SUG (Rs b)		6.9	7.2	7.5	7.7	8.0	9.0	9.0
Working capital (WC, Rs b)		2	2	2	2	2	2	3
Change in WC (Rs b)		(1.7)	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)	(0.0)
NFA and Capex [4] (Rs b)	(80.7)	(31.0)	(19.2)	(8.0)	(8.0)	(5.7)		
Net cash flow (Rs b)	**(80.7)**	**(10.5)**	**3.1**	**14.9**	**15.7**	**18.8**	**27.7**	**23.4**
NPV at RoCE (pre-tax)	**0**							

Source: Company/Infraline/Industry/MOSL

Despite estimated hike, we build flat HVJ-DVPL tariff

Based on our calculations, we expect HVJ-DVPL tariffs to increase. However, we do not build the same in our base estimates, as PNGRB reserves the right to qualify the future capex assumptions and could tweak the allowable capex for tariff calculations.

HVJ-DVPL tariffs would increase when "PNGRB will combine all the spurs in a single network and then compute tariffs." However, there remains a possibility that PNGRB may exclude some planned spur lines from HVJ-DVPL network leading to flat/lower headline tariff number.

TRANSMISSION BUSINESS: OUR KEY ASSUMPTIONS

PIPELINE-WISE VOLUMES (MMSCMD)	FY09	FY10E	FY11E	FY12E	FY13E	FY14E
HVJ-DVPL/GREP	60.1	76.7	90.0	102.6	102.6	109.6
Dhabol- Bangalore					8.0	12.0
Kochi - Mangalore - Bangalore					8.0	12.0
Jagdishpur - Haldia					16.0	24.0
DUPL/DPPL	10.8	14.0	16.0	24.0	24.0	24.0
Rajasthan	5.2	5.2	5.2	5.2	5.2	5.2
KG Basin	0.5	7.0	13.0	13.0	13.0	13.0
Cauvery	3.0	3.0	3.0	3.0	3.0	3.0
Others	4.2	4.2	4.2	4.2	4.2	5.2
Total	**83.8**	**110.1**	**132.0**	**152.0**	**184.0**	**208.0**
Tariff Assumptions (Rs/mscm)						
HVJ-DVPL/GREP	975	975	975	975	975	975
Dhabol- Bangalore	-	-	-	-	1,960	1,960
Kochi - Mangalore - Bangalore	-	-	-	-	1,382	1,382
Jagdishpur - Haldia	-	-	-	-	1,675	1,675
DUPL/DPPL	870	870	870	870	870	870
Rajasthan	363	363	363	363	363	363
KG Basin	530	530	530	530	530	530
Cauvery	665	665	665	665	665	665
Others	449	449	449	449	449	449
Average Tariff	**825**	**840**	**869**	**878**	**1,016**	**1,063**

Source: Company/MOSL

Prima-facie, based on regulations, the entire HVJ-DVPL network should be considered as a single network for tariff determination. However, there might be a case where PNGRB may eliminate some of the spurs (especially the ones for which activity like ROU, procurement is yet to begin) from the main network and work out tariff for HVJ-DVPL network and "those" spurs separately. In such case, the capital employed for HVJ-DVPL network may decrease marginally. This should reduce the chances of tariff hike for HVJ-DVPL network. In such a case, GAIL will have to charge tariff differentially to HVJ-DVPL and spurlines. The combined revenue from HVJ-DVPL network and spurs excluded from HVJ-DVPL network would be equal to or 10-20% higher than that computed considering it as a single network.

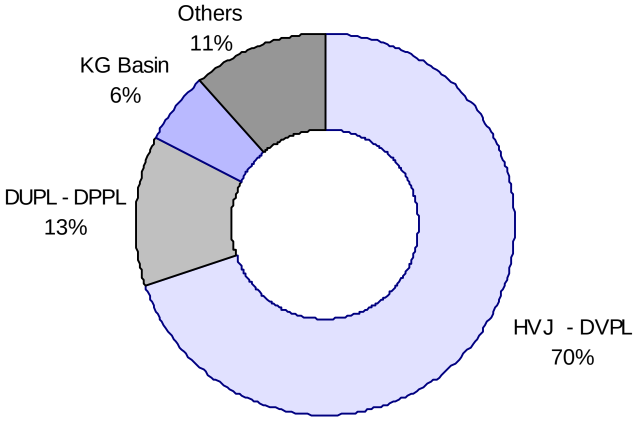
Why are HVJ-DVPL tariffs important for GAIL?

HVJ-DVPL contributes over 65% of GAIL's total volumes

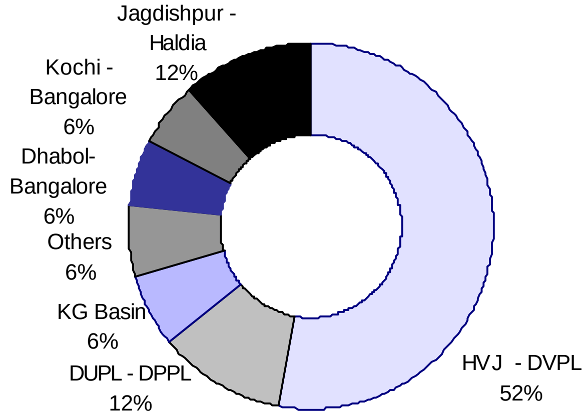
HVJ-DVPL is the key pipeline network for GAIL, as it accounts for >65% of its total transmission volumes and a similar share in its profitability. GAIL is expanding the capacity of this network from the current 57mmscmd to 100mmscmd by 2011. While the share of HVJ-DVPL in GAIL's total volumes transmitted would decline, as its other transmission networks are commissioned, it would still be significant at >50% in FY14.

HVJ-DVPL WILL CONTINUE TO ACCOUNT FOR >50% OF TOTAL VOLUMES (%)

CURRENT VOLUME DISTRIBUTION



FY14 LIKELY DISTRIBUTION



Source: Company/MOSL

FACTORS AND IMPLICATIONS OF LIKELY PNGRB TARIFF FOR HVJ-DVPL

	TARIFF CHANGE	
KEY FACTORS	FLAT TARIFF (OUR BASE CASE)	INCREASE IN TARIFF
Pipeline Network	Would consider only current pipeline network and spurs where work has commenced	Would consider current as well as planned pipelines over next 5 years (as tariff revision is only after 5 years)
Capital Employed	Base on NFA and capex committed	Based on NFA and planned capex over next 5 years
Implications	Though HVJ-DVPL headline tariff would remain flat; returns on additional capex (same network) would accrue through new tariff as and when new pipelines/spur get commissioned	

Source: Company/MOSL

PNGRB methodology for tariff determination

The Petroleum and Natural Gas Regulatory Board (PNGRB) has proposed tariff calculations using the discounted cash flow method (DCF), based on the following:

1. **Rate of return:** 12% post-tax RoCE (18.2% pre-tax, grossed up at nominal tax rate of 33.99%).
2. **Capital employed:** The capital employed is defined as net fixed assets (for existing pipelines) till date + planned capex + working capital. The working capital allowed is 30 days of operating expenses and 18 days of receivables.
3. **Operating expenses:** To be taken at actual (existing) or normative basis (new pipelines); including spares, repairs and maintenance, salaries, overheads, etc. The cost of gas used for own consumption is also a pass-through.
4. **Transmission volumes:** Pipeline capacity will be split into 'common carrier' (25%) and 'contract carrier' (75%). Common carrier volumes for tariff calculation will be considered as provided by the company, while for contract carrier a minimum ramp-up profile is mandated by PNGRB (Year 1 - 60%, Year 2 - 70%, Year 3 - 80%, Year 4 - 90%, Year 5 - 100%).

Other regulatory stipulations

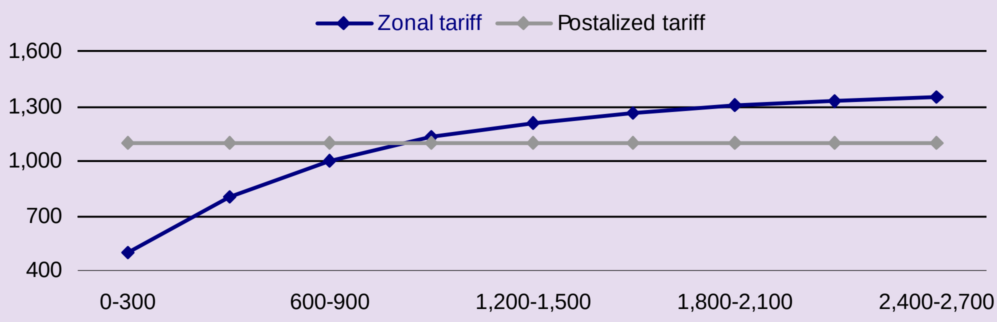
1. The economic life of pipeline is considered as 25 years.
2. The Board prescribes 355 working days (10 days for planned customer maintenance). However, transporters are demanding 345 working days (additional 10 days for their own maintenance). We consider 350 days for our calculation.
3. Opex is at 3% of NFA plus planned capex. This is a pass-through; hence, there is no impact on EBITDA.
4. **Internal consumption for compressors:** 3.5% of the volume transported. The international benchmark for pipelines above 1,000km length and 60mmscmd is 3-4%. It is a pass-through and has no impact on EBITDA.
5. **Long-term inflation to compute opex:** 4%.

Tariffs would be zonal, but average tariff for GAIL would remain same

Historically, India has seen postalized tariff, i.e. same tariff for all customers located on a pipeline. However, going forward, with a large number of gas sources, long distance networks, customers across the length of pipelines, it will become necessary to have different tariffs. PNGRB has advocated zonal tariffs in its guidelines:

1. Every pipeline/network to be divided in zones, each of 300km.
2. All customers located in a zone shall have same (postalized) tariff.
3. A customer located far away from source should pay higher tariff than near one.

REPRESENTATIVE ZONAL AND POSTALIZED TARIFF



Source: : Industry,/PNGRB/MOSL

Like Tariff Commission, even PNGRB proposes 12% post-tax RoCE

12% RoCE has been the norm even historically

Transmission tariffs for HVJ and DVPL have been periodically revised by the government. However, it has kept the RoCE largely at 12% (post-tax) - the rate also proposed by PNGRB. Besides, the government has kept the dedicated pipelines out of the purview of the regulations, thereby incentivizing the transporter and promoting the penetration of gas network.

PNGRB PROPOSED AND TARIFF COMMISSION METHODOLOGY COMPARISON

DESCRIPTION	TARIFF COMMISSION	PNGRB
Return on investment	12% post tax	12% post tax
Capital employed	Fixed Assets plus CWIP plus	NFA plus planned capex plus CWIP
Tariff Review period	5 years	5 years
Capacity Utilization	95% of total capacity	Progressive increase in utilization % (Year 1- 60%, Year 2 – 70%, Year 3- 80%, Year 4 – 90%, Year 5- 100%)
Working capital allowed		18 days receivables and 30 days opex
Inflation	Indexed to change in CPI	Silent on Inflation, it is expected to incorporate some number

Source: Company/Infraline/MOSL

HISTORICAL TARIFF CHANGES FOR HVJ-DVPL

PERIOD	DETERMINED BY	METHODOLOGY	TARIFF (RS/MSCM)	REMARKS
Hazira - Vijaipur Pipeline (HVJ)				
1985	Committee of Secretaries	12% IRR	850	Rs1,074 for non-fertilizer and non-power
1991	Kelkar Committee		850	Continued earlier tariff
1997	Sankar Committee	DCF (12% post-tax return)	1,150	1% hike for every 10% increase in CPI. Variation to be paid through gas pool account.
Dahej - Vijaipur Pipeline (DVPL)				
Apr-04	Government	DCF (12% RoI)	500 (in Gujarat); 632 (till Vijaipur); 653 (beyond Vijaipur)	Zonal tariffs
HVJ - GREP - DVPL Combined				
2006	Tariff Commission	Cost of Service Method	965	Indexation with variation in fuel cost, inflation, tax rates and volumes.
Current	PNGRB	DCF (12% post-tax RoCE)	Under review	Expected to be approved by Dec-09

Source: Company/Infraline/MOSL

Significant upside potential from CGD business

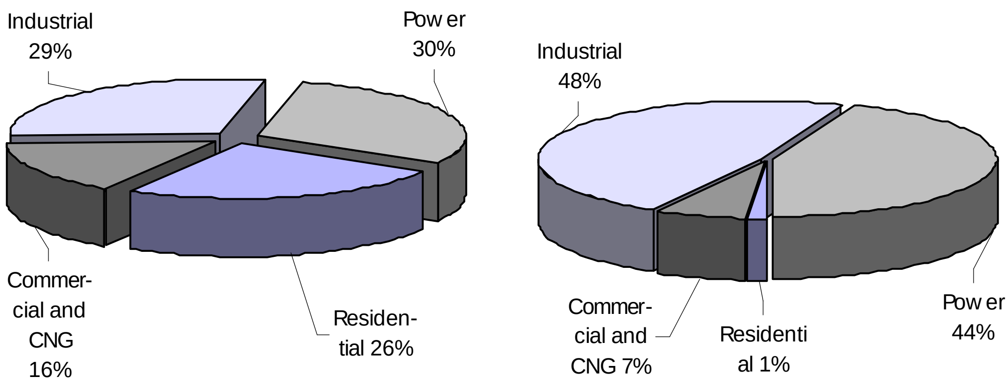
We believe gas availability and attractive economics would drive significant CGD business growth in India, with a potential to reach 200 cities and 80mmscmd volume. Through its JVs, GAIL already has presence in 12 cities and plans to ramp up to 45-50 cities in the next five years. We currently value only IGL (at Rs3/share) and estimate near-term upside potential of Rs27/share from CGD (not factored in our target price).

CGD: huge potential in India

Historically, gas supplies have been directed to power and fertilizer companies in India. Since its availability was scanty, natural gas consumption in households was not being encouraged. This has changed with greater gas availability. With PNGRB in full action, GAIL and other upstream players charging up, a majority government at the center, we expect a big boost to CGD. Consumption in households, vehicles and commercial facilities will enable efficient utilization of natural gas.

RESIDENTIAL GAS CONSUMPTION IN INDIA IS MINISCULE

UNITED STATES INDIA



Source: Company/MOSL

City gas distribution in India offers huge potential

Given the huge potential the business offers, a large number of players have shown great interest in setting up CGD networks in various parts of the country. Of India's total population of 1.1b, almost 30% stay in non-rural areas. These areas, as per our survey, can be connected with gas grids and basic infrastructure within the next 10 years. Thus, a 330m population can be connected with gas infrastructure.

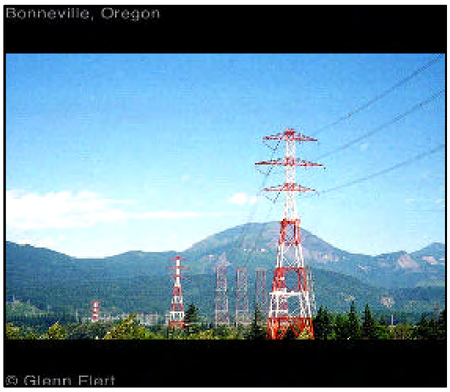
The global average per capita gas consumption (CNG and PNG) is 0.1scmd, translating into a whopping demand of 33mmscmd for residential use. Small scale industries' requirement is estimated as 28mmscmd. This demand has been computed considering the possibility of change in infrastructure, with greater availability of gas. Global benchmark figures for per capita gas consumption for small-scale industries vary from 0.6scmd to 1.2scmd, depending on the extent of industrialization and penetration.

The benefits of gas have already been witnessed by few cities in India. However, gas distribution even in these cities remains short of full potential. India's CGD networks current supply is 9mmscmd (inclusive of industrial consumption in Gujarat) gas to about 900,000 consumers. In comparison, CGD coverage in Pakistan is 38mmscmd gas supply to 1.9m consumers. Different agencies, including both government and private bodies, have estimated CGD gas consumption at ~80mmscmd for 200 cities. The government has also made known its intention to give high priority to CGD, as it promotes more efficient use of gas.

EFFICIENCY OF UTILIZATION

FERTILIZER 75%

POWER 48%



CITY GAS 95%

Source: Company/MOSL

The regulator, PNGRB has 'suo moto' raised the EOI for different cities to set up CGD networks. Different operators are targeting to cover over 250 cities/towns. With the advent of new gas supplies, CGD is the most relevant and high value end application for natural gas. The efficiency of energy utilized in CGD is over 90%. CGD covering the large cities would be the next growth phase for gas consumption in India.

GAIL: the pioneer in setting up distribution networks for large cities

GAIL is the pioneer in setting up distribution networks for large cities

Through its nine joint ventures (JVs), GAIL has a presence in more than 12 cities. It plans to expand its network to 45-50 cities in the next 4-5 years, with a gas volume potential of 25mmscmd (IGL currently supplies just ~2.1mmscmd). We believe CGD would lead to long-term value creation for GAIL and 25mmscmd volumes would add Rs27/share (GAIL's 22.5% stake in IGL, with 2mmscmd volume is valued at Rs3/share).

CURRENT CGD NETWORKS

CITY	MMSCMD
Hyderabad	0.2
Vijaywada	0.1
NCR and NCT	1.8
Vadodara	0.0
Mumbai	1.5
Lucknow	0.1
Kanpur	0.1
Bareily	0.1
Total	**3.9**

Source: Company/MOSL

GAIL HAS PRESENCE IN 9 CGD NETWORKS

	OPERATOR	JV PARTNER	CITIES COVERED / TARGETED	STATUS
1	Mahanagar Gas Ltd	British Gas, Maha Gov.	Mumbai, Thane and Mira-Bhayander	CNG/PNG operational
2	Indraprastha Gas Ltd	BPCL, Delhi Gov.	Delhi & Noida	CNG/PNG operational
3	Bhagyanagar Gas Ltd	HPCL, AP Govt.	Hyderabad, Vijayawada	CNG operational
4	Central UP Gas Ltd	BPCL, UP Govt.	Kanpur	CNG operational
5	Green Gas Ltd	IOCL, UP Govt.	Lucknow and Agra	CNG operational
6	Tripura Natural Gas	Assam & Tripura Govt.	Agartala	CNG/PNG operational
7	Avantika Gas Ltd	HPCL, MP Govt.	Indore	Under implementation
8	GAIL - VMMS Ltd	VMMS	Vadodara	CNG operational
9	Maharashtra Natural Gas	BPCL, Maha Gov.	Pune	CNG operational

Source: Company/MOSL

GAIL has set up a 100% subsidiary, GAIL Gas Limited, as proposed by PNGRB, wherein the CGD business will be at arms length from the gas marketing business. Since its incorporation, GAIL Gas has already bid for 9 cities and has won the rights for four (Dewas, Kota, Meerut and Sonepat).

NEW MOU'S SIGNED BY GAIL

COMPANY / JV PARTNER	CITIES TARGETED	STATE
HPCL	Ahmedabad, Surendranagar, Rajkot, Vadodara	Gujarat
GAIL Gas	Meerut, Kota, Sonepat and Dewas	Uttar Pradesh
BPCL	Bangalore	Karnataka
BPCL	Alappuzha, Kochi, Kottayam, Thrisur, Mallapuram, Kozhikode, Kannur	Kerala
IOCL	Kolkata	West Bengal

Source: Company/MOSL

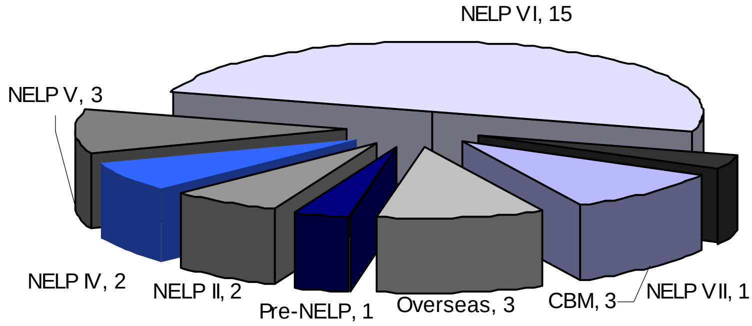
We believe that GAIL Gas' initial target would be small industries and commercial consumers. Then it would concentrate on the higher margin transport fuel through the development of CNG networks in the cities. Piped natural gas targeting domestic households would be the last priority, in our view, given the currently subsidized LPG pricing regime.

Valuing E&P business at Rs23/share

GAIL has stakes in 27 E&P blocks and three CBM blocks (as a non-operator in 28 blocks and as an operator in two blocks). Of these, 15 were acquired in the NELP-VI round and the three CBM blocks were acquired in the CBM-III round. The company has invested Rs18.3b in E&P till date and has planned capex of Rs49b by FY14.

Though it has a significant capex plan, we believe GAIL is taking a cautious approach to its E&P business as seen in its typical participating interest of 10-30% in its blocks. It has reported hydrocarbon discoveries in eight of its blocks till date. Its overseas blocks in Myanmar are in advanced stages (FDP to be approved soon) and are likely to commence production in 2013.

GAIL'S E&P PORTFOLIO MIX (NO OF BLOCKS)



Source: Company/MOSL

Myanmar block: Based on third-party estimates (Gaffney, Cline & Associates), the total estimated gas in place is of the order of 4.6-7.8tcf. Gas from this block will be sold to a Chinese company, China National United Oil Corporation through a gas pipeline connecting to China. The planned plateau rate is 14mmscmd, with production commencement in 2013. We value the Myanmar block at Rs15/share.

Other blocks: Among its other key blocks, we value Block 56 located in Oman at Rs5/share and an onland block in Cambay at Rs2/sh. In block CY-OS/2 (GAIL's share: 25%), Hardy (JV partner and operator) has applied for the extension of appraisal period to Jan-2012 to prove commerciality of Ganesha gas discovery in block.

We value GAIL's E&P business at Rs23/share

We currently value the initial estimates of in-place reserves/contingent resources that are available for four of the blocks. Our current valuation of GAIL's five blocks is US$593m (Rs23/share).

E&P BUSINESS CURRENTLY VALUED AT RS22.5/SH

	INPLACE RESOURCES (MMBOE)	RECO-VERY (%)	RECO-VERABLE (MMBOE)	VALUA-TION (US$/BOE)	VALUE (US$M)	STAKE (%)	GAIL STAKE VALUE (US$M)	RS M	RS/SH
A1, Myanmar*	1,008	60	604.8	4.5	2,722	10.0	272	13,064	11
A3, Myanmar*	396	60	237.6	4.5	1,069	10.0	107	5,132	4
Block 56 (Oman)	250	50	125.0	4.5	563	25.0	141	6,750	5
CB-ONN-2000/1	50	35	17.5	5.5	96	50.0	48	2,310	2
CY-OS/2	114	25	22.8	4.5	103	25.0	26	1,231	1
Total							**593**	**28,487**	**23**

* Certified by GCA

Source: Company/MOSL

Likely petchem downturn built in our estimates

GAIL intends to increase its petchem capacity from the current 410KTA to 500KTA by March 2009 and further to 800KTA by March 2012. Additional petchem supplies from new capacities in the Middle East and China would put pressure on GAIL's petchem business margins. We have factored a sharp drop in margins in our FY11 estimates. However, the overall impact on GAIL would be minimal.

Pressure on petchem margins imminent…

Though pressure on petchem margins is imminent due to overseas capacity additions…

Pressure on petchem margins is imminent due to new capacities in the Middle East and China. Though these capacities have been delayed for the last 3-6 months, we believe they are likely to increase supplies substantially towards end-2009 and eventually put pressure on global petchem prices.

…but domestic players protected to some extent

…domestic players are protected to some extent

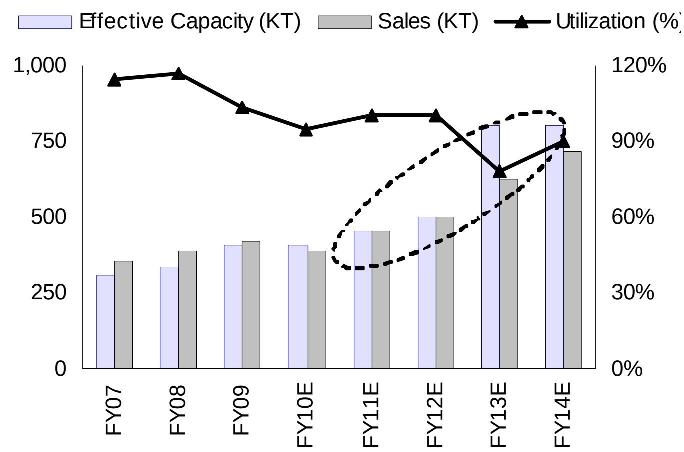
However, margins of domestic players will be protected to some extent due to: (1) freight cost advantage, and (2) duty structure in India. The government has already imposed anti-dumping duties on VCM (raw material for PVC), and in July 2009, it imposed provisional (for six months) anti-dumping duty on PP originating from Oman, Saudi Arabia and Singapore.

GAIL's profitability more dependent on selling price

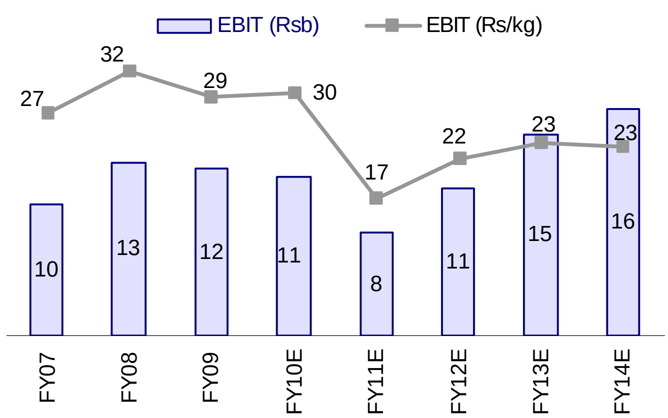
Despite lower margins, we expect GAIL's petchem EBIT to increase

As GAIL has a gas-based petchem production capacity and since gas prices are fixed, its profitability is more dependent on the selling price. We have built the likely downturn in our estimates. Despite lower margins, we expect GAIL's petchem EBIT to improve due to capacity expansion.

PETCHEM CAPACITY TO DOUBLE BY FY12/13



DESPITE LOWER MARGINS, PETCHEM EBIT TO IMPROVE DUE TO CAPACITY EXPANSION



Source: Company/MOSL

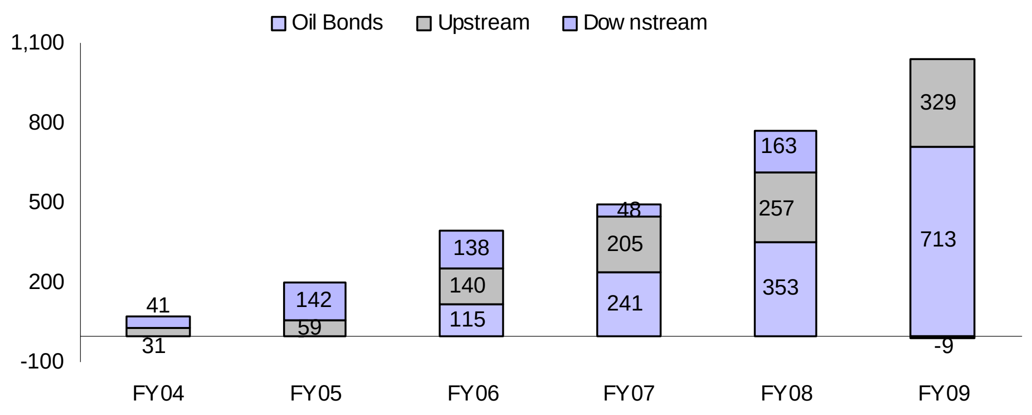
Subsidy rationalization is a likely trigger

Subsidy sharing has historically been ad-hoc. With the FY09 memories still fresh (the government had to issue Rs713b of oil bonds), we believe the government is seriously working on subsidy rationalization. A new Expert Group has been set up to recommend a sustainable sector strategy. Since there is no clear policy defined on future subsidy sharing yet, we build in sharing similar to 1HFY10. Upstream companies had shared 100% of the auto fuel under-recoveries, with GAIL's share at 13%. We build in upstream subsidy sharing at 90% of the auto fuel under-recoveries for FY11.

FY09 oil bonds issue more than previous three years combined

Led by high oil prices, fixed retail prices and exchange rate depreciation, FY09 gross under-recoveries stood at over Rs1t, resulting in stretched financials for oil companies as well as the government. The government had to dole out oil bonds to the tune of Rs713b - more than the combined oil bonds issued in the previous three years.

FY09 OIL BONDS: HIGHEST EVER ISSUED (RS B)



Source: Bloomberg/PPAC/MOSL

New Expert Group set up to recommend sustainable sector strategy

The government appears to be seriously working on subsidy rationalization

The government has so far addressed the under-recoveries situation in an ad-hoc manner. With the FY09 memories (had to issue Rs713b of oil bonds) fresh, we believe the government is seriously working towards key policy decisions for the oil & gas sector. It has set up a committee to recommend a "viable and sustainable pricing policy". This committee is expected to submit its report by end January 2010.

Terms of reference of the Expert Group

- To examine the current pricing policy of the four sensitive petroleum products - Petrol, Diesel, PDS Kerosene and Domestic LPG, and to make recommendations for a viable and sustainable pricing policy for these products.
- This may, inter-alia include:
  a) Examination of the current taxation structure on the sensitive petroleum products, with particular reference to Petrol and Diesel and make recommendations to rationalize the taxes levied by the Central and State Governments.
  b) Examination of the financial health of the Public Sector Oil Marketing Companies and to recommend ways of compensating them for their under-recoveries in case they are not permitted to charge market prices as a result of Government's intervention, in order to protect consumers.
  c) Any other matter, which the Expert Group may consider necessary.

We build GAIL's subsidy sharing similar to 1HFY10 in our estimates

We build GAIL's subsidy sharing similar to 1HFY10 in our estimates

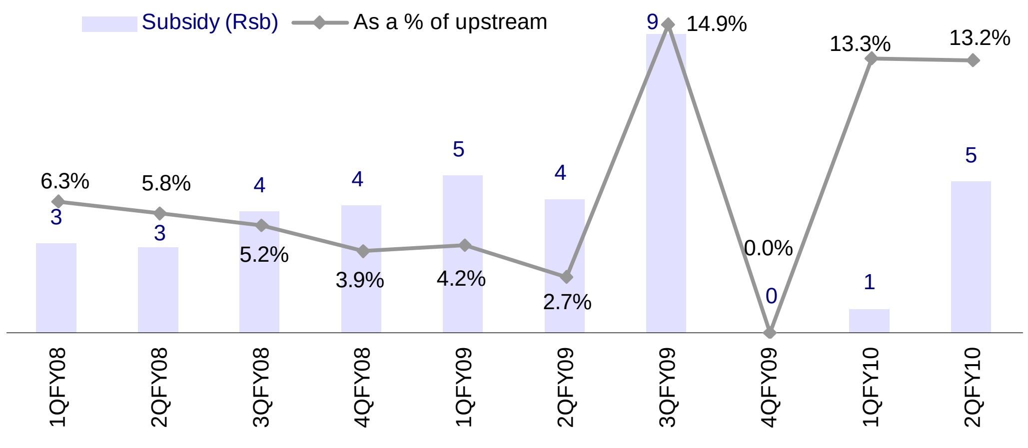
Though there is no clear policy on future subsidy sharing yet, we build in sharing similar to 1HFY10. Upstream companies had shared 100% of the auto fuel under-recoveries, with GAIL's share at 13%. We believe that GAIL's subsidy sharing was decided based on its share in the sum of the profits of ONGC, GAIL and Oil India for FY09. We build in upstream subsidy sharing at 90% of the auto fuel under-recoveries for FY11 at Rs5.5b.

1HFY10 SUBSIDY BASED ON FY09 PAT OF UPSTREAM COMPANIES

	PAT (RSB)	SUBSIDY BURDEN (RSB)		
	FY09	1QFY10	2QFY10	1HFY10
ONGC	164.3	4.3	26.3	30.6
OIL	21.6	0.6	3.9	4.5
GAIL	28.0	0.8	4.6	5.3
Total	**213.9**	**5.6**	**34.8**	**40.4**
Sharing (%)				
ONGC	77	76	76	76
OIL	10	10	11	11
GAIL	13	13	13	13
Total	**100**	**100**	**100**	**100**

Source: Company/MOSL

GAIL'S HISTORICAL SUBSIDY BURDEN



Source: Company/PPAC/MOSL

Valuation and view

GAIL offers good earnings visibility and superior long-term growth. We expect 14% CAGR in revenues and 21% CAGR in EBITDA (23% excluding subsidy) over FY09-14. With the transmission business accounting for over 65% of EBIT, we expect GAIL's valuation multiples to converge with utilities players. We are increasing our FY11E EPS by 7.5% to Rs27.3 and revising our SOTP-based target price from Rs365 to Rs485.

We are positive on GAIL due to:

1. *long-term revenue visibility*
2. *value creation through CGD*
3. *potential upside from E&P*
4. *possible subsidy rationalization*

We remain positive on GAIL primarily due to: (1) long-term revenue visibility, (2) value creation through the CGD business, (3) potential upside from its E&P business, and (4) likely favorable policy decision on subsidy. Risks to our estimates would be higher than anticipated subsidy burden.

Key assumptions

We have built gas transmission volume growth of 20% CAGR to 208mmscmd by FY14. We have not factored in any meaningful capacity increase for GAIL's LPG production and transmission business, and have built in conservative price realizations. We factor in upstream subsidy sharing at 90% of the auto fuel under-recoveries in our assumptions. Our key earnings model assumptions are summarized below.

OUR KEY ASSUMPTIONS

	FY07	FY08	FY09	FY10E	FY11E	FY12E	FY13E	FY14E
Exchange Rate (Rs/US$)	**45.2**	**40.2**	**46.1**	**47.6**	**46.0**	**44.5**	**43.0**	**42.0**
Subsidy (Rsb)	**14.9**	**12.9**	**17.8**	**16.6**	**12.3**	**5.5**	**0.0**	**0.0**
Natural Gas Transmission								
Volume (mmsmd)	77	82	83	110	132	152	184	208
Average Tariff	787	763	825	840	869	878	1,016	1,063
LPG Transmission								
Volume ('000 MT)	2,491	2,754	2,744	2,933	3,006	3,097	3,189	3,285
Average Tariff (Rs/MT)	1,381	1,416	1,390	1,415	1,415	1,415	1,415	1,415
Petrochemicals								
Petchem Sales ('000 MT)	354	391	423	390	455	500	625	720
Realization (Rs/kg)	73	66	67	67	53	58	59	59
EBIT (Rs/kg)	27	32	29	30	17	22	23	23
LPG & Liq HC								
Sales ('000 MT)	1,346	1,348	1,405	1,435	1,441	1,470	1,499	1,529
Realization (US$/MT)	593	732	830	646	650	600	600	600

Source: Company/MOSL

Improving earnings quality

We estimate that the share of gas transmission business (annuity type earnings) in total EBIT will be more than 65%, implying high quality of earnings.

EBIT BUILD-UP (RS B)

	FY07	FY08	FY09	FY10E	FY11E	FY12E	FY13E	FY14E
Natural Gas Transmission	15.2	15.5	16.1	24.7	28.5	32.1	44.4	52.4
LPG Transmission	1.9	2.3	2.2	2.5	2.5	2.6	2.8	2.9
Natural Gas Trading	1.9	2.0	3.5	4.5	5.2	5.2	5.2	5.3
Petrochemicals	9.5	12.5	12.2	11.5	7.5	10.8	14.6	16.5
LPG & Liquid HC (pre-subsidy)	15.9	21.9	26.5	17.7	21.9	18.0	17.3	16.8
Other	0.0	(2.1)	(1.7)	(1.5)	0.1	0.1	0.1	0.1
Total	**44.5**	**52.2**	**58.8**	**59.4**	**65.7**	**68.8**	**84.3**	**94.0**
Less: Subsidy	(14.9)	(12.9)	(17.8)	(16.6)	(12.3)	(5.5)	0.0	0.0
Total EBIT	**29.6**	**39.4**	**41.0**	**42.8**	**53.4**	**63.3**	**84.3**	**94.0**

Source: Company/MOSL

Tax benefits on new pipelines to reduce effective tax rate

New pipelines would get tax benefits

The Finance Bill 2009 proposed an 'investment bases incentive' for new pipelines commissioned post April 2008 under Section 35 AD. Section 35 AD, read in conjunction with Section 28, stipulates that the entity shall be allowed a deduction in respect of expenses of capital nature (other than land or goodwill or financial instrument) incurred by it in the previous year. Profits from new pipelines fall under this section and companies will have to pay only MAT on these profits.

As a result, GAIL's effective tax rate would decline

GAIL benefits from this incentive, as it has already commissioned its DUPL pipeline in FY09 and is going to commission three major cross-country pipelines in next 2-3 years. GAIL is currently a full tax paying company (~33%) and we expect its effective tax rate to reduce to 28% by FY14.

FY11E EPS AT RS27.3

	FY10E	FY11E
Current	22.7	25.6
Revised	22.7	27.3
Change (%)	0.0	7.5

Source: Company/MOSL

Raising EPS estimate for FY11 by 7.5%

We are increasing our FY11E EPS by 7.5% to Rs27.3 (from Rs25.6). We have now factored in no increase in HVJ-DVPL tariff (earlier 10% decline).

SENSITIVITY TO KEY ASSUMPTIONS

	-20%	-10%	BASE	+10%	+20%
Transmission Volumes	24.3	25.8	27.3	28.8	30.3
Change in EPS (%)	*-11.0*	*-5.5*		*5.5*	*11.0*
HVJ-DVPL Tariff	25.0	26.2	27.3	28.5	29.6
Change in EPS (%)	*-8.4*	*-4.2*		*4.3*	*8.5*
Average Tariff	24.3	25.6	27.3	28.8	30.3
Change in EPS (%)	*-11.0*	*-6.2*		*5.6*	*11.1*
Petchem Price	24.8	26.0	27.3	28.6	29.9
Change in EPS (%)	*-9.3*	*-4.6*		*4.8*	*9.5*

Source: Company/MOSL

Revising target price to Rs485; maintain Buy

Buy with a target price of Rs485

We value GAIL on SOTP basis at Rs485 (core business at 14x FY12E EPS), investment value of Rs54/share and E&P value of Rs23/share). We believe there is further upside potential of at least Rs27/share from its CGD foray. Adjusted for investments, the stock trades at 11.7x FY12E EPS of Rs29.1. We maintain **Buy**.

GAIL: SOTP VALUATION (RS)

BUSINESS		REMARKS
FY12 EPS	29.1	
PE Multiple (x)	14.0	7% discount to domestic and global utility companies
Value (Rs/Share)		
Core Business	408	Gas transmission comprises 65% of core business
E&P	23	4 key blocks valued on in-place/contingent resources
Listed Investments	46	20% discount to CMP/target price
Unlisted Investments	8	At Book Value
Target price	**485**	
Upside Potential		
CGD (additional 25mmscmd)	27	Not factored in our target price
Value with Upside Potential	**512**	

Source: MOSL

RELATIVE VALUATION (GLOBAL GAS TRANSMISSION COMPANIES)

	P/E (X)			P/BV (X)			EV/EBITDA (X)		
	CY09	CY10	CY11	CY09	CY10	CY11	CY09	CY10	CY11
Asia									
Xinao Gas Holdings Ltd	22.3	18.1	15.2	3.7	3.2	2.7	12.3	10.4	9.1
Perusahaan Gas Negara PT	17.2	14.8	12.3	8.1	6.1	4.7	10.7	9.3	8.2
Petronas Gas BHD	21.6	20.1	18.7	2.5	2.4	2.3	10.5	9.6	9.1
APA group	21.7	18.5	17.8	1.9	1.7	1.8	10.8	9.8	9.4
US									
Kinder Morgan Energy Prtnrs	43.9	29.2	25.1	2.7	2.8	2.9	11.2	9.6	8.9
Energy Transfer Partners LP	18.2	16.1	14.9	1.8	2.0	2.1	10.2	8.7	7.8
Oneok Partners LP	18.0	16.8	15.7	2.0	2.0	1.9	12.7	11.3	10.5
Boardwalk Pipeline Partners	38.3	20.8	20.1	1.6	1.6	1.7	17.6	12.9	11.7
Williams Cos Inc	22.8	15.7	12.5	1.5	1.4	1.3	6.7	5.9	5.0
EL Paso Corp	9.0	11.4	10.1	3.2	2.6	2.1	6.6	7.1	6.4
Europe									
Enagas	13.2	12.0	11.1	2.4	2.2	2.1	9.4	8.3	7.7
Fluxys-D	16.3	16.0	14.9	1.2	1.1	1.1	7.9	7.6	7.3
National Grid Plc	13.8	11.5	11.3	3.3	3.2	2.7	10.4	9.0	8.7
Snam Rete Gas	14.8	13.0	12.6	1.8	1.8	1.8	11.6	9.3	8.8
Global Average	**20.1**	**16.5**	**15.0**	**2.8**	**2.5**	**2.3**	**10.6**	**9.2**	**8.5**
GAIL		**12.5**	**11.7**	**3.2**	**2.7**	**2.4**	**9.1**	**8.0**	**7.9**

Source: Bloomberg

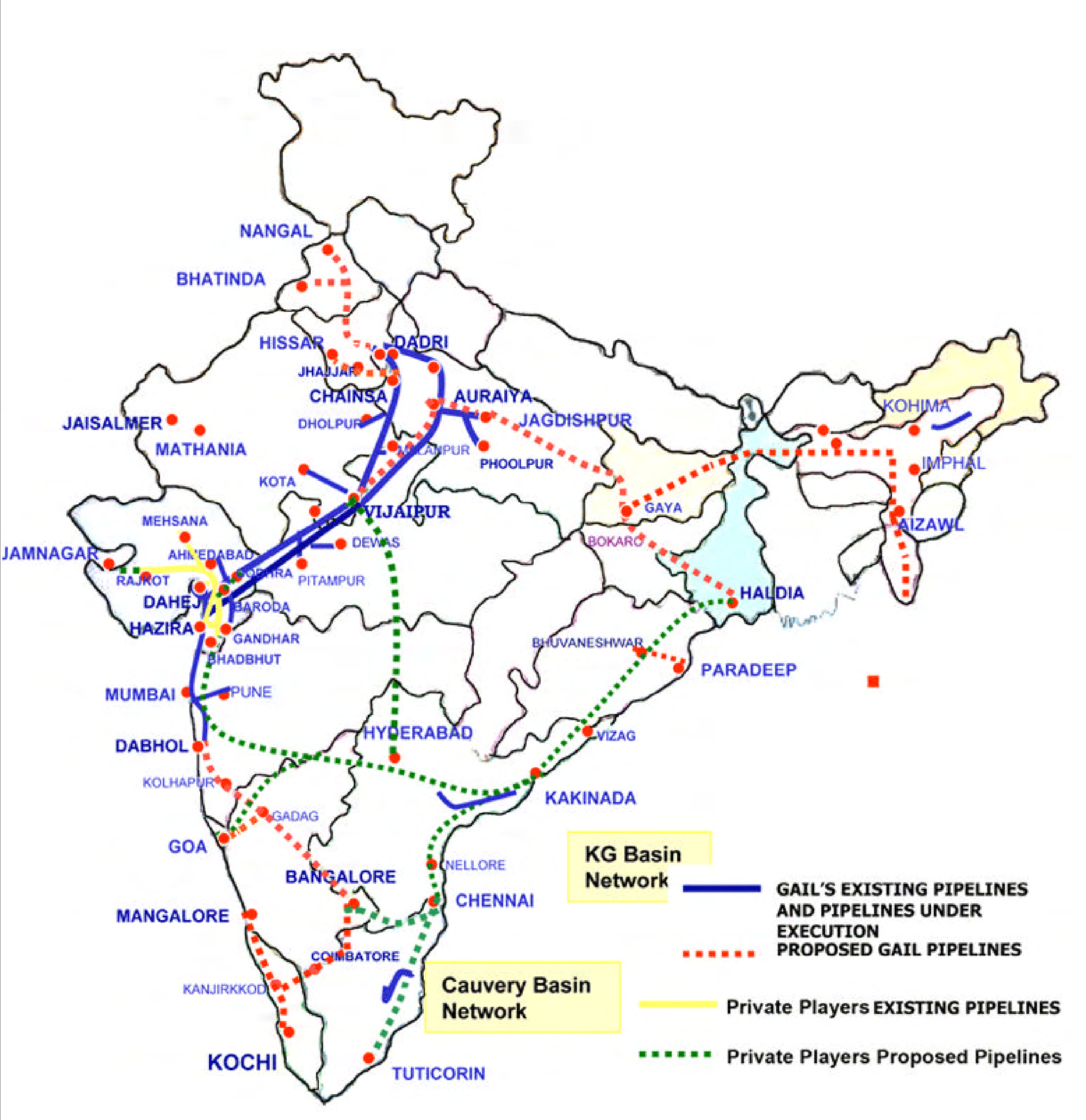
Annexure I: GAIL's E&P portfolio

	Block	NELP Round	Gail's Stake	Operator	Non Operating Partners	Location	Offshore/ Onshore
Domestic Blocks							
1	MN-OSN-2000/2	NELP - II	20%	ONGC - 40%	IOC - 20%; OIL - 20%	Mahanadi	Deep w ater
2	CB-ONN-2000/1	NELP - II	50%	GSPC - 50%		Cambay	Onland
3	AA-ONN-20D2/1	NELP - IV	80%	OGPL - 20%		Tripura	Onland
4	CY-ONN-2002/1	NELP -IV	50%	JOGPL - 30%	GSPC - 20%	Cauvery	Onland
5	CY-OS/2	Farm-in	25%	HEPI - 75%		Cauvery	Offshore
6	CB-ONN-2003/2	NELP - V	20%	GSPC - 50%	JCPL - 20%; GGR - 10%	Ankleshw ar	Onland
7	AN-DWN-2003/2	NELP - V	15%	ENI - 40%	ONGC - 45%	Andaman-Nicobar	Deep Water
8	AA-ONN-2003/1	NELP - V	35%	JOGPL -10%	GSPC - 20%; JSPL - 35%	Golaghat	Onland
9	Y-DWN-2004/1	NELP - VI	10%	ONGC - 70%	GSPC 10%; HPCL - 10%	Cauvery	Deepw ater
10	CY-OWN-2004/2	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL - 10%	Cauvery	Deepw ater
11	CY-DWN-2004/3	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL 10%	Cauvery	Deepw ater
12	CY-DWN-2004/4	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL - 10%	Cauvery	Deepw ater
13	CY-PR-DWN-2004/1	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL - 10%	Cauvery-Palar	Deepw ater
14	CY-PR-DWN-2004/2	NELP - VI	10%	ONGC - 70%	GSPC 10%; HPCL - 10%	Cauvery-Palar	Deepw ater
15	KG-DWN-2004/1	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL - 10%	Krishna-Godavari	Deepw ater
16	KG-DWN-2004/2	NELP - VI	10%	ONGC - 60%	GSPC - 10%; HPCL - 10%; BPCL - 10%	Krishna-Godavari	Deepw ater
17	KG-OWN-2004/3	NELP - VI	10%	ONGC - 70%	GSPC - 10%; HPCL - 10%	Krishna-Godavari	Deepw ater
18	KG-DWN-2004/5	NELP - VI	10%	ONGC - 50%	GSPC - 10%; HPCL - 10%; OIL - 10%; BPCL - 10%	Krishna-Godavari	Deepw ater
19	KG-DWN-2004/6	NELP - VI	10%	ONGC - 60%	GSPC - 10%; HPCL - 10%; OIL - 10%	Krishna-Godavari	Deepw ater
20	RJ-ONN-2004/1	NELP - VI	20%	GSPC - 20%	HPCL - 20%; BPCL - 10%; Hallw orthy -20%; NITINFIRE 10%	Rajasthan	Onland
21	KG-ONN-2004/2	NELP - VI	40%	GSPC - 40%	PETROGAS - 20%	Krishne-Godavari	Onland
22	MB-OSN-2004/1	NELP - VI	20%	GSPC - 20%	IOC - 20%; HPCL - 20%; PETROGAS - 20%	Mumbai	Offshore
23	MB-OSN-2004/2	NELP - VI	20%	Petrogas - 20%	IOC - 20%; GSPC - 20%; HPCL - 20%	Mumbai	Offshore
24	CY-ONN-2005/1	NELP - VII	40%	GAIL - 40%	GSPC - 30%; Bengal Energy - 30%	Cauvery	Onland
Overseas Blocks							
25	Block 56, Oman	Bidding	25%	Oilex NL -25%	Videocon -25%; BPCL - 12.5%; HPCL -12.5%	Oman	Onland
26	A-1 M anmar	Farm-in	10%*	Daew oo - 60%	OVL - 20%; KOGAS -10%	Myanmar	Onshore
27	A-3 Myanmar	Farm-in	10%*	Daew oo - 60%	OVL - 20%; KOGAS - 10%	Myanmar	Onshore
CBM Blocks							
1	RM-CBM-2005/III	CBM - III	35%	Arrow Energy - 35%	EIG - 15%; Tata Pow er - 15%	Raj Mahal	Onland
2	TR-CBM-2005/III	CBM - III	35%	Arrow Energy - 35%	EIG-15%; Tata Pow er - 15%	Tatapani Ramkola	Onland
3	MP-CBM-2005/III	CBM - III	45%	Arrow Energy - 40%	EIG - 15%	Mand Raigarh	Onland

DW - Deepw ater, SW- Shallow w ater, Onland

* Will reduce to 8.5% if Myanmar govt. exercises its option to acquire additional 15% of GAIL's stake

Annexure II: Envisaged gas pipeline network of India



Financials and valuation

INCOME STATEMENT						(RS MILLION)
Y/E MARCH	2009	2010E	2011E	2012E	2013E	2014E
Net Sales	**237,760**	**259,256**	**329,089**	**371,647**	**415,206**	**455,057**
Change (%)	*32.0*	*9.0*	*26.9*	*12.9*	*11.7*	*9.6*
Total Income	**237,760**	**259,256**	**329,089**	**371,647**	**415,206**	**455,057**
Purchase	150,804	165,656	208,971	235,996	255,352	282,135
Raw Materials	21,283	24,743	32,909	37,165	41,521	45,506
Employee Costs	5,767	5,190	5,709	6,280	6,908	7,598
Power & Fuel & Other Expenses	19,412	18,878	23,974	21,305	16,552	14,251
Change in Stocks	-50	0	0	0	0	0
EBITDA	**40,544**	**44,789**	**57,525**	**70,902**	**94,874**	**105,567**
% of Net Sales	*17.1*	*17.3*	*17.5*	*19.1*	*22.8*	*23.2*
Depreciation	5,599	6,061	7,922	11,184	14,870	16,607
Interest	870	1,073	2,356	9,149	16,304	16,439
Other Income	7,966	5,106	3,745	3,496	4,250	4,995
PBT	**42,041**	**42,761**	**50,992**	**54,064**	**67,951**	**77,516**
Tax	14,003	13,980	16,340	17,110	19,817	22,035
Rate (%)	*33.3*	*32.7*	*32.0*	*31.6*	*29.2*	*28.4*
Adjusted PAT	**28,511**	**28,780**	**34,652**	**36,954**	**48,134**	**55,481**
Reported PAT	**28,037**	**28,780**	**34,652**	**36,954**	**48,134**	**55,481**
Change (%)	*7.8*	*2.7*	*20.4*	*6.6*	*30.3*	*15.3*

BALANCE SHEET						(RS MILLION)
Y/E MARCH	2009	2010E	2011E	2012E	2013E	2014E
Share Capital	12,685	12,685	12,685	12,685	12,685	12,685
Reserves	135,012	154,888	180,635	208,685	247,915	294,492
Net Worth	**147,696**	**167,572**	**193,320**	**221,370**	**260,600**	**307,176**
Long Term Loans	12,001	18,659	48,659	154,659	207,659	157,659
Deferred Tax	13,259	13,384	15,423	17,586	20,304	23,405
Capital Employed	**172,957**	**199,615**	**257,402**	**393,615**	**488,563**	**488,240**
Gross Fixed Assets	176,040	227,995	300,144	445,481	545,819	561,319
Less: Depreciation	85,537	91,597	99,519	110,704	125,573	142,180
Net Fixed Assets	**90,503**	**136,398**	**200,624**	**334,778**	**420,246**	**419,139**
Capital WIP	24,263	24,263	24,263	24,263	24,263	24,263
Investments	17,373	16,009	16,009	16,009	16,009	16,009
Curr. Assets, L & Adv.						
Inventory	6,014	6,867	7,771	8,365	8,813	9,405
Debtors	15,033	14,520	17,350	19,778	22,655	25,088
Cash & Bank Balance	34,562	9,747	6,907	10,780	21,988	25,679
Loans & Adv. and Other Assets	66,756	65,268	65,499	65,753	66,033	66,340
Current Liab. & Prov.						
Liabilities	41,779	49,285	56,406	60,848	64,030	68,433
Provisions	39,769	24,172	24,616	25,263	27,414	29,250
Net Current Assets	**40,818**	**22,945**	**16,506**	**18,565**	**28,045**	**28,829**
Application of Funds	**172,957**	**199,615**	**257,402**	**393,615**	**488,563**	**488,240**

E: MOSL Estimates

Financials and valuation

RATIOS

Y/E MARCH	2009	2010E	2011E	2012E	2013E	2014E
Basic (Rs)						
EPS	22.5	22.7	27.3	29.1	37.9	43.7
Cash EPS	26.5	27.5	33.6	38.0	49.7	56.8
Book Value	116.4	132.1	152.4	174.5	205.4	242.2
DPS	7.0	6.0	6.0	6.0	6.0	6.0
Payout	31.1	26.4	22.0	20.6	15.8	13.7
Valuation (x)						
P/E	19.0	18.5	15.3	14.4	11.0	9.6
Cash P/E	15.8	15.3	12.5	11.0	8.4	7.4
EV / EBITDA	8.8	9.1	8.0	7.9	6.5	5.3
EV / Sales	1.8	1.8	1.5	1.6	1.5	1.3
Price / Book Value	3.6	3.2	2.7	2.4	2.0	1.7
Dividend Yield (%)	1.7	1.4	1.4	1.4	1.4	1.4
Profitability Ratios (%)						
RoE	19.0	17.2	17.9	16.7	18.5	18.1
RoCE	24.8	22.0	20.7	16.1	17.2	19.2
Turnover Ratios						
Debtors (No. of Days)	23	20	19	19	20	20
Fixed Asset Turnover (x)	1.4	1.3	1.3	0.9	0.8	0.9
Leverage Ratio						
Debt / Equity (x)	0.1	0.1	0.3	0.7	0.8	0.5

CASH FLOW STATEMENT (RS MILLION)

Y/E MARCH	2009	2010E	2011E	2012E	2013E	2014E
OP/(Loss) before Tax	42,040	42,761	50,992	54,064	67,951	77,516
Depreciation	5,599	6,061	7,922	11,184	14,870	16,607
Other op items	-1,279	0	0	0	0	0
Direct Taxes Paid	-15,009	-13,856	-14,300	-14,947	-17,099	-18,935
(Inc)/Dec in Wkg. Capital	-5,573	-6,942	3,599	1,814	1,728	2,907
CF from Op. Activity	**25,779**	**28,024**	**48,213**	**52,115**	**67,450**	**78,095**
(Inc)/Dec in FA & CWIP	-25,301	-51,955	-72,149	-145,338	-100,338	-15,500
(Pur)/Sale of Investments	-2,443	1,364	0	0	0	0
Inc from Invst	5,223	0	0	0	0	0
CF from Inv. Activity	**-22,522**	**-50,591**	**-72,149**	**-145,338**	**-100,338**	**-15,500**
Issue of Shares	0	0	0	0	0	0
Inc / (Dec) in Debt	-1,553	6,657	30,000	106,000	53,000	-50,000
Dividends Paid	-11,872	-8,904	-8,904	-8,904	-8,904	-8,904
CF from Fin. Activity	**-13,425**	**-2,247**	**21,096**	**97,096**	**44,096**	**-58,904**
Inc / (Dec) in Cash	**-10,168**	**-24,814**	**-2,840**	**3,873**	**11,208**	**3,691**
Add: Opening Balance	44,730	34,562	9,747	6,907	10,780	21,988
Closing Balance	**34,562**	**9,747**	**6,907**	**10,780**	**21,988**	**25,679**

E: MOSL Estimates

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Disclosure of Interest Statement	GAIL (India)
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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