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GAIL (INDIA) RATING: **HOLD**

Scale of tariff revision was a disappointment

While GAIL is likely to appeal decision, FY20/21e Ebitda is down 4.7/4.2%; TP cut to ₹367; 'Hold' retained as valuation is fair

PETROLEUM AND NATURAL Gas Regulatory Board (PNGRB) has approved the long-pending tariff revision for HVJ/HVJ expansion pipelines, thereby taking care of the tariff revisions until FY24. Key highlights: (i) Blended tariff at ₹1.7/scm is 11.5% lower than our estimate of ₹2/scm, but 0.4% higher than the earlier tariff; (ii) however, this is 58% below GAIL's submission (₹4.1/scm) due to much lower tariffs for the HVJ pipeline; (iii) with the two pipelines contributing over 60% to GAIL's overall throughput, the tariff revision prompts a 9.9%/9.3% cut in FY20/21e transmission Ebitda; and (iv) however, given the PNGRB's volume assumptions of 80mmscmd (currently 65mmscmd), we believe GAIL is likely to appeal the PNGRB order. We are revising down the TP by 4.4% to ₹367/share due to a 4.7%/4.2% cut in FY20/21e Ebitda. Retain **Hold** as the stock is fairly priced at 5.3x FY21E EV/Ebitda.

Tariff hike misses estimate; also lower than GAIL submission

According to PNGRB regulations, instead of separate tariffs for the two pipelines, an integrated tariff will be levied on combined volumes. Consequently, integrated tariff will drive future revenue. The hike of just 0.4% is 20% lower than what we had factored in. The revised tariff also significantly undercuts the tariff submitted by GAIL.

Higher volumes/disallowance of opex drives miss

Over 35% of the deviation between GAIL's submission and the approved blended tariff is due to the PNGRB's notably higher volume assumption of 80mmscmd vis-a-vis current volume of 65mmscmd. Another 24% of deviation is attributable to non-acceptance of a certain portion of the past and future opex submitted by GAIL. Consequently, we believe GAIL is likely to appeal the PNGRB order.

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Financials

(₹ mn)

Y/E March	FY19	FY20e	FY21E	FY22E
Net revenue	761,899	921,952	1,081,403	1,109,521
Ebitda	96,676	108,307	122,350	131,900
Adjusted Profit	65,457	71,573	85,233	96,752
Adjusted diluted EPS (₹)	29.0	31.7	37.8	42.9
Diluted P/E (x)	10.9	10.0	8.4	7.4
EV/ Ebitda (x)	7.4	6.5	5.3	4.5
ROAE (%)	14.9	14.5	16.1	16.6

Source: Company data, Edelweiss research

Outlook: Fairly priced

Given the disappointing tariff revisions, we expect GAIL's earnings to remain fairly muted at a 13.8% CAGR over FY19–22e. A potential split and sale of the marketing division provides an upside risk though. Retain **Hold** with a revised TP of ₹367/share with valuations at 6.2x FY21e EV/Ebitda fully pricing in earnings growth.

Investment Theme

Demand for gas is expected to grow faster due to the inherent advantages of gas as a fuel over other fossil fuels and infrastructural bottlenecks being eased due to large investments being made in the gas sector. Earlier, energy-intensive sectors like fertilisers, power generation, and refining have been restricted/forced to use liquid fuels due to paucity of gas. But, with the setting up of the national gas grid and availability of imported gas, more industries will be able to use gas as fuel. GAIL has 5 approved (by MoPNG before the PNGRB came into existence), un-built pipelines; which have been assured 12% post-tax ROCEs with uncapped leverage, while all future pipelines will have bidding based tariffs. This single-window opportunity to take advantage of higher tariffs (due to the high, assured returns) during a strong volume growth period, provide upsides to GAIL's earnings. Rising oil price, stabilisation of its expanded petrochemical capacity bode well.

Key risks: (i) Tariff reduction in existing pipelines may be higher than estimated. (ii) Rise in crude prices may increase under-recovery sharing burden on GAIL.

Company description: GAIL is a dominant player in India involved in business of sourcing, transportation, distribution, and processing of natural gas in India. The company owns >11,000 km of natural gas pipelines. GAIL has also forward integrated itself by putting a LPG-separation plant, a 810 KTPA of ethylene gas-based cracker and further downstream Polyethylene. The firm dominates the city gas distribution business as it either has stakes in the CGD entities or runs the same through its 100% subsidiary Gail Gas Ltd.

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