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GAIL chairman and managing director, Dr Ashutosh Karnatak (centre) and company directors at the 35th Annual General Meeting of GAIL (India) Limited

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GAIL loses steam as financial, operational challenges bite

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State-owned gas utility firm GAIL (India)'s investment plan to expand the National Gas Grid and city gas distribution network over the next five years bodes well for the firm.

GAIL India — the country's largest gas pipeline operator — has more than 11,000 km of pipeline network, and markets two-thirds of the country's natural gas. However, near-term concerns are likely to weigh on its financial performance and stock.

New tariffs levied by the regulator for some of its pipelines, such as Hazira-Vijaipur-Jagdishpur (HVJ), have been a setback. This led analysts to cut their earnings estimate, following which the stock price corrected by close to 30 per cent between June and early August.

The stock, which scaled to its 31-month low on August 8, has seen marginal gains after the June quarter (Q1) performance came in line with estimates. However, this was largely on account of better-than-expected earnings in the trading segment. Most other businesses disappointed, and volumes were sub-par across segments.

For instance, the petrochemicals business registered an operating loss, hurt by weak realisations, despite soft prices of the key input liquefied natural gas.

The natural gas transmission segment saw volumes decline 2 per cent year-on-year (YoY), owing to closure of some fertiliser plants. Although this segment's earnings before interest and tax (Ebit) still improved 22 per cent YoY in Q1, volumes in the liquefied petroleum gas (LPG) and liquid hydrocarbons businesses also fell, due to lower offtake by customers.

The firm's overall performance rode on the 50 per cent jump in gas trading profits. The improvement in margins was surprising, given the weak demand-supply situation.

Concerns over placement of the high-priced US gas contracts remain, even though GAIL has consistently met with success in placing them and reporting good numbers. Analysts at Motilal Oswal say the company has hedged sufficient US cargo for FY20 and FY21, though it remains to be seen how these US contracts work in an environment of increasing LNG supply glut.

On the domestic front, the extremely challenging macro environment is marked by falling Asian spot LNG prices, which are currently just $2.5 per mBtu (million British thermal unit) lower than the landed cost of US LNG, say analysts. The Street will watch the trend in trading margins, while the near-term outlook for petrochemicals' margins and other segments remains subdued.

Among the near-term positives is the commissioning of pipelines such as Kochi-Mangaluru. The company expects to complete this in a few months, which can provide some volume growth, says Nilesh Ghuge of HDFC Securities. Increased utilisation at Petronet LNG's recent capacity ramp-up, which could boost transmission volumes, will add to the same, he added.

Ghuge, however, expects the Jagdishpur-Haldia and Bokaro Dhamra pipeline (JHBDPL) to boost volumes only after the second half of FY22.

In the long run, there is no doubt on GAIL's prospects, considering the strong natural gas demand. Other factors are the continuous growth of piped natural gas and compressed natural gas segments, and the tightening norms on industrial pollution.

However, lack of clarity over restructuring of the firm is affecting outlook. Analysts at Motilal Oswal have lowered their valuation multiple from 9x to 8x on concerns over restructuring.

Prabhudas Lilladher analysts said valuations remain attractive but added that concerns over demerger of its pipeline network remains a concern.

They have also tweaked their FY20/21 estimated earnings to incorporate annual report changes and expect capital expenditure trajectory to pick up as all businesses (excluding pipeline) operate at near-peak levels.

	Net sales (₹ cr)	% chg (YoY)	Ebidta (₹ cr)	% chg (YoY)	Net profit* (₹ cr)	% chg (YoY)
FY19	75,126	40.0	9,555	25.2	6,352	38.4
FY20E	74,692	-0.6	9,826	2.8	6,521	2.7
FY21E	84,895	13.7	10,603	7.9	7,372	8.7

E: estimates; * adjusted for one-time items; Ebidta: earnings before interest, depreciation, tax and amortisation
Source: Prabhudas Lilladher Research