



GAIL's metrics see silver lining with likely rebound in trading biz

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Positive developments on the vaccine front have raised expectations of a recovery in demand for oil and gas and related products. GAIL Ltd, a leading upstream gas company in India, is naturally expected to gain. Investors had started taking cues from a better-than-expected Q2 performance itself, when there was a marked improvement in profitability in various segments. Not surprisingly, the stock has gained around 46% since its October lows and is seeing regular earnings upgrades from analysts.

Prospects for gas demand in the country already remain strong.

Though 2020 may have seen lockdown woes and has not been much of a favourable year, uptick from hereon is expected. The requirement for cleaner and cheaper fuel by industrials and automobiles, and expanding pipeline infrastructure and city gas distribution network expansions bode well for the company.

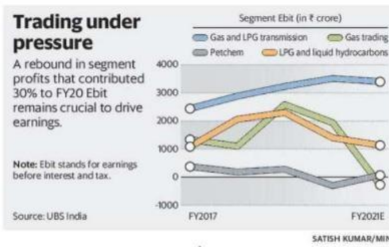
The demand outlook for other oil commodity segments is also favourable. The petchem (petrochemicals) segment turned profitable in Q2 itself, after losses in Q1, as volumes surged with the progressive lifting of curbs. The LPG and hydrocarbon segments are on a better footing with margins improving. The petchem margin expansion trend, never-

Trading under pressure

A rebound in segment profits that contributed 30% to FY20 Ebit remains crucial to drive earnings.

Note: Ebit stands for earnings before interest and tax.

Source: UBS India



theless, needs to be watched considering huge capacity expansions underway globally. Higher supplies outpacing demand can put pressure on realizations again. Meanwhile, as gas transmission

business continues to see better volumes, all eyes are on the profitability of the gas trading business. Lower spot gas prices have meant that GAIL saw losses in the gas trading segment, with placement

of take-or-pay US gas contracts at lower prices. On the positive side, spot gas prices are improving. Expected demand uptick in the country, upcoming completion of GAIL's Kochi-Mangaluru pipeline and commissioning of fertilizer plants should aid better placement of contracts henceforth.

"We estimate a turnaround in gas trading profitability from a loss in H1FY21 to a profit in H2FY21 with FY22-23 segment earnings reaching FY17-18 levels" says Amit Rustagi at UBS India Research. Analysts are betting on commissioning of three fertilizer plants at Gorakhpur, Sindri and Barauni along with demand from refineries (connected to the Urjan-Ganga pipeline) to increase

gas sales by 11 mmscmd (million standard cubic metre per day) over the next few years. This means better placement of gas.

However, timely project completion holds the key for these expectations to be met. GAIL had contracted imported gas cargoes, anticipating a demand surge.

Analysts' positive stance is also based on seven new pipelines starting by FY23, which should aid transmission volumes to grow by almost 35% by FY23.

Trading at 8.2 times the FY22 earnings estimates, valuations are comforting too and are at a huge discount to the long-term 1-year forward price to earnings multiple of 13.2 times that GAIL has historically traded on.

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