

# Trading segment leads Q1 beat for GAIL but Russian gas supply a worry

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**N**ear-term uncertainties around supplies from Russia are keeping markets cautious despite GAIL India Ltd reporting strong numbers for the quarter that ended in June. The stock continued its downwards journey and closed 5.17% lower Friday.

The company's reported net profits of ₹2,915 crore were up 90.5% year-on-year (y-o-y) and 9% sequentially. This was better than Bloomberg consensus earnings estimates of ₹2,416 crore. It recorded a 116%

increase in revenue from operations to ₹37,572 crores in Q1FY23. On a sequential basis the revenue grew 39%.

This was driven by the strong performance of the gas trading business that saw revenue grow more than two folds on a y-o-y basis and up more than 50% sequentially. The segment's profitability remains strong and analysts attribute this to very high differentials between Asian liquefied natural gas (LNG) prices and US Henry Hub benchmarks. Even the gas transmission business was supportive, though volume growth was softer and analysts attributed it



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to higher gas prices.

Nevertheless, these segments took care of the weakness in the petrochemicals segment, which saw a signifi-

cant decline in volumes even as realisations remained supportive. The company attributed the positive results to increased gas marketing and

transmission volumes, better marketing spread and higher product prices.

The company's earnings before interest, tax, depreciation, and amortisation (Ebitda) at ₹4,365 crore improved 81% y-o-y and 17.5% sequentially.

Despite the strong beat, the concerns of the street are related to lower gas supplies from Russia. Analysts said that gas trading volumes remained strong in Q1, up 5% y-o-y, but this segment will

remain soft in 2QFY23, led by a loss of volumes because supply issues from Gazprom.

GAIL has a portfolio of 14 million tonnes per annum of long-term LNG contracts from various sources including Gazprom, it said. There have been supply disruptions under the contract since late May 2022 and Gazprom has not

delivered eight shipments to GAIL. In June 2022, GAIL got only one shipment of LNG.

If Gazprom triggers the

force majeure clause, it will lead to higher gas prices, according to analysts at Motilal Oswal Financial Services Ltd. This may result in a slightly lower offtake as some consumers may not be able to afford higher gas prices.

The inability of Gazprom to supply contracted LNG to GAIL since June could impact marketing volume by 5-6 million metric standard cubic metres per day (mmscmd) and transmission volume by 6-7 mmscmd, as well as impact petrochemical plant utilization during Q2FY23, according to Elara Securities India Pvt Ltd.

**The good results were attributed to increased gas marketing, transmission volumes, higher product prices**

● GAIL RATING: BUY

# Supply disruption poses earnings risk

Strong profit in Q1; EPS for FY23-24e down 8-11%; target price cut to ₹185 from ₹205; 'Buy' retained

**STRONG PROFIT OF ₹29 bn**(c9%q-o-q) in Q1 driven by record marketing Ebitda of ₹24 bn had little meaning as supply disruption in the current quarter puts future earnings at risk. Company indicated that its LNG cargoes from Gazprom Marketing and Trading Singapore (2.5 mmtpa contract) have been disrupted since June and will likely impact c6mmscmd of marketing volumes. Company will try to honour its external sales contract by reducing any extra supply and maintaining its minimum supply as per the contract, by taking some extra cargoes from the US and reducing its own consumption at the Pata petrochemical complex.

This should hurt the profitability of the transmission, marketing and petrochemical businesses. It also expects a further increase in domestic gas price which should negatively impact the profitability of its LPG segment. Persistently high gas prices are also impacting the profitability of its transmission business on account of internal consumption but should be recovered by tariff revisions in the future. Also, the current environment of weak naphtha spreads over crude is hurting the relative attractiveness of its gas-based petrochemical plant.

**Longer-term momentum remains largely unchanged:** The currently high global prices are a spanner in the works for gas demand growth. However, we believe increasing city gas distribution penetration and increased production of gas from Reliance will lift gas demand. The current utilisation rate for GAIL's pipelines is c55%. As demand increases, higher utilisation should flow straight to the bottom-line. In addition, a significant part of its

## Estimate changes ▲ Change %

Estimate	Change	Value
Ebitda (₹ m)		
FY23e	8	103,772
FY24e	9	104,668
FY25e	NA	107,685

Estimate	Change	Value
PAT (₹ m)		
FY23e	8	73,867
FY24e	10	73,418
FY25e	NA	74,746

Estimate	Change	Value
EPS (₹/sh)		
FY23e	8	16.6
FY24e	10.5	16.5
FY25e	NA	16.8

Source: HSBC estimates

pipelines are still under construction. As these are commissioned, demand should rise and improve the company's ROE. GAIL is also ramping up in the renewables space.

**Risk-reward favourable:** We cut our FY23e-24e EPS estimates by 8-11% due to lower transmission and petchem volumes and higher domestic gas prices impacting LPG profitability. We also introduce FY25e EPS. The stock trades at a 1-year forward PE multiple of 9x, which is at a 25% discount to its 10-year mean despite much improved visibility on demand and project commissioning. We retain **Buy** rating as GAIL should be a key beneficiary of the increasing share of gas in the energy mix. We lower our TP to ₹185 (from ₹205). Key downside risks: 1) lower-than-estimated transmission tariffs and gas volumes; 2) fall in petchem spreads versus our assumptions; and 3) regulatory unbundling of its gas transmission business at significantly below its replacement costs; and 4) persistently high gas prices.

HSBC





### **गेल ने पहली तिमाही में 37572 करोड़ का राजस्व कमाया**

नई दिल्ली। गैस अथॉरिटी ऑफ इंडिया (गेल) ने चालू वित्तीय वर्ष की पहली तिमाही में 37572 करोड़ का राजस्व कमाया है, जो कि पिछले वित्तीय वर्ष में इस अवधि में हासिल किए गए 17387 करोड़ रुपये से 116 फीसदी अधिक है। कंपनी का टैक्स चुकाने से पहले लाभ 90 फीसदी बढ़कर 3,894 करोड़ रुपये हो गया है, जो कि पिछले वित्तीय वर्ष की इसी तिमाही में 2,054 करोड़ था। इसी तरह टैक्स चुकाने के बाद लाभ 91 फीसदी बढ़कर 2,915 करोड़ रुपये हो गया है, जबकि पिछले वित्तीय वर्ष की इसी तिमाही में 1,530 करोड़ रुपये था।