

GAIL (India) Ltd.Rs239
NEUTRAL

RESULT NOTE

Mkt Cap: Rs203bn; US\$4.4bn

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Result: Q1FY07

Comment: Lower contribution to under-recoveries improves profitability

Last report: 28 April 2006 (Price Rs290; Recommendation: Neutral)

Key valuation metrics

Year to March 31 (Rs m)	Net sales	yoy change (%)	Net profit	EPS (Rs)	yoy chg (%)	EV/E (x)	PER (x)
2005	138,523	11.6	19,468	23.0	3.6	5.5	10.4
2006	166,124	19.9	21,758	27.3	18.7	5.4	8.8
2007E	162,354	-2.3	23,293	27.5	0.9	5.2	8.7
2008E	169,715	4.5	24,353	28.8	4.6	4.9	8.3

GAIL's Q1FY07 performance (earnings growth of 22.5%yoy to Rs 5921m) was ahead of our expectations due to lower under recovery contribution of Rs 2.50 bn and lower tax rates. The petrochemicals division came out with impressive performance on the back of increased sales despite higher natural gas prices. We maintain our FY07 & FY08 earnings estimates at Rs27.5 and Rs28.8. Stock has limited upside, given no major proposed gas volume increase in the near term whereas ad-hoc contribution to under-recoveries remains a concern. Stock is valued at EV/E of 5.2x FY07E. Maintain Neutral.

OTHER SALIENT HIGHLIGHTS OF THE QUARTER ARE AS BELOW

- Gas transmission volumes improved sequentially from 78.3mscmd to 79.1mscmd due to partial restoration of oil fields destroyed by fire at Bombay high.
- As a result, gas transmission EBITDA rose 5% qoq to Rs 5.17bn.
- Gas trading EBITDA continued to display volatility and was down 48% to Rs 270 m from Rs520m in Q1FY06 and (600) mn in Q4FY06.
- Petrochemical EBITDA was up to Rs2380mn in Q1FY07 from Rs1680mn in Q1FY06 due to higher petrochemical sales (up 30.6% yoy to 81,000MT in Q1FY07) and margin improvement despite higher gas prices.
- LPG EBITDA fell 32% yoy to Rs 1610mn due to higher LPG and SKO under recovery contribution of Rs 2.5bn as against Rs 1.53bn in Q1FY06.
- Depreciation charges fell 41% yoy to Rs 1408m due to change in depreciation policy on pipeline depreciation to 3.17% from 10.34%.
- The company's other income increased 60.4% yoy to Rs 801mn.
- Net profits were also assisted by lower tax rates (30.5% in Q1FY07 vis-à-vis 33.7% in Q1FY06).

Operational & financial performance

	Q1FY05	Q2FY05	Q3FY05	Q4FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	Q1FY07
Gas transmission (mscmd)	69.1	71.4	73.3	77.7	78.9	76.8	81.4	78.3	79.1
Gas sales (mscmd)	66.1	67.7	69.5	73.5	72.4	77.9	69.2	68.4	70.0
LPG and liquid prodn ('000 MT)	327	370	363	334	325	312	344	350	356
Petrochemical sales ('000 MT)	70	68	69	111	62	61	75	104	81
LPG transmission ('000 MT)	421	544	602	570	487	508	543	690	522
EBITDA breakup (Rs mn)									
Gas transmission	4,300	4,870	5,080	4,000	4,930	4,960	5,210	4,530	5,170
Gas trading/marketing	500	(100)	800	1,400	520	1,340	(650)	(600)	270
LPG & liquid hydrocarbons	1,030	2,090	2,080	1,700	2,360	1,490	2,620	470	1610
Petrochemicals	1,550	2,280	2,340	3,170	1,680	1,710	2,130	3,000	2,380
LPG pipeline/Gaitlet/unallocated	1,112	529	1,330	570	490	540	1,320	490	790
Total	7,992	9,769	11,630	10,840	9,980	10,040	10,630	7,890	10,220

Note: EBITDA in the above table includes other income classified in the respective segments

□ Limited upside from current levels, reiterate Neutral

GAIL is trading at a PER of 8.7x and EV/E of 5.2x FY2007E. We maintain our FY07 and FY08 earnings estimates at Rs27.5 and Rs28.8 respectively. We believe that any improvement in bottomline this year and the next year will be driven by non-operational factors like contribution to subsidy whereas at the operational level its EBITDA will see a muted growth on account of increase in gas prices. Stock has limited upside, given no major proposed gas volume increase in near future. Reiterate Neutral with a price target of Rs257.

Earnings model

Year to March 31 (Rs m)	Q4FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06	Q1FY07
Net sales	36,101	36,242	40,738	44,455	42,078	163,513	40,784
yoy change (%)	6.7	11.8	15.6	27.9	16.6	18.0	12.5
Operating profit	10,341	9,480	9,344	9,111	7,044	34,979	9,416
yoy change (%)	(4.8)	24.1	6.4	(11.1)	(31.9)	(5.5)	(0.7)
Other income	490	499	1693	1519	844	4,555	801
Interest	314	297	178	406	292	1,173	288
Depreciation	2,306	2,391	399	1,414	1,391	5,595	1,408
PBT	8,211	7,292	10,461	8,809	6,205	32,766	8,521
Tax rate (%)	37.1	33.7	26.0	27.0	34.0	29.5	30.5
Tax	3,047	2,457	2,719	2,378	2,112	9,666	2,600
Net profit	5,164	4,835	7,742	6,432	4,093	23,101	5,921
yoy change (%)	(19.2)	42.6	69.7	1.2	(20.8)	18.7	22.5
Operating parameters							
OPM (%)	28.6	26.2	22.9	20.5	16.7	21.4	23.1
NPM (%)	14.3	13.3	19.0	14.5	9.7	14.1	14.5
Other income/PBT (%)	6.0	6.8	16.2	17.2	13.6	13.9	9.4
Valuation							
Outstanding shares (m)	846	846	846	846	846	846	846
EPS (Rs)	6.1	5.7	9.2	7.6	4.8	27.3	7.0
Cash EPS (Rs)	8.8	8.5	9.6	9.3	6.5	33.9	8.7

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1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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