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THE COMPASS

Multiple triggers to boost GAIL stock

Source: Exchange
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The public sector gas utility GAIL (India) has seen re-rating and upgrades from some analysts who see rising transmission volumes and a likely turnaround in the petrochemicals business. Analysts are projecting a strong improvement in the return on equity (RoE) to around 15 per cent by FY26 from around 9.5 per cent in FY23. They are also assuming an Ebitda CAGR (compounded annual growth rate) of 32 per cent from FY23-FY26.

This is based on upcoming gas price-related tariff hikes and the onset of new projects. The capex will also rise but the Gail group of companies may generate a free cash flow of ₹4,500-4,600 crore in FY26. Optionality from subsidiary GAIL gas could lead to value unlocking of up to ₹14.3 per share for the parent GAIL.

GAIL distributes gas with 40 per cent going to fertilisers, 25 per cent to city gas distributors (CGD), 11 per cent to power, 9 per cent to overseas companies and the remaining 15 per cent to steel, refineries, sponge iron, and internal consumption. It has six subsidiaries, nine joint ventures and 11 associate companies.

In H1 FY24, Ebitda declined by 3 per cent year-on-year (Y-o-Y) to ₹6,240 crore due to a decline in LPG & liquid hydrocarbons and an operating loss of ₹463 crore in petrochemicals.

But in Q2FY24, on a quarter-on-quarter (Q-o-Q) basis, Ebitda saw strong growth due to better trading margins and higher transmission volumes.

Transmission volume projections are of 9 per cent CAGR, with volumes rising to 140 mmscmd by FY26 from 107 mmscmd in FY23.

This assumes a utilisation rate of around 65 per cent by FY26, up from 52 per cent in FY23.

The growth would be supported by higher domestic output. Reliance Industries (RIL) will ramp up production from KG-D6 to 30 mmscmd, while ONGC will increase gas production from KG-DWN-98/2 by 7-8 mmscmd in FY25.

Oil India expects gas production to jump 20 per cent YoY in FY26 after the completion of the Indradhanush Gas Grid.

Consumption will be aided by a rise in LNG regasification capacity, given five new LNG terminals and also new liquefaction capacity coming online in the US and Qatar. This should keep a ceiling on spot LNG prices.

The petrochemical segment should become profitable at the EBIT level by FY26, driven by improvement in polyethylene (PE) and polypropylene (PP) prices. Petrochemical demand should start to pick up from H2FY25 (October 2024) given low global inventories. Korean petrochemical players in their Q3CY23 earnings commentaries have said demand growth should exceed capacity additions globally for PE/PP. Polyester demand should see support from low global textile inventories.

GAIL's petchem base is set to diversify across products as new PP and PTA capacities come online, giving it exposure to more product segments. GAIL will use both natural gas and propane as feedstock and it could still maintain margins even if there's a surge in price for one of these gases.

Softer spot LNG prices will help it hit the $10 per mmBtu breakeven level in petchem segment. The new 500,000 tonnes per annum propane dehydrogenation plant to polypropylene at Usar will be running at full capacity by FY26, adding 9 per cent to the standalone estimated Ebitda and also by then, an additional 3,892 km of gas transmission pipelines will be fully operational.

Potential risks include volatile gas prices. Also as of now, petrochemicals spreads are still falling. But the stock, which hit a record high of ₹164.25 in intra-day trade on Friday, is still moderately valued which is why analysts see significant upside, given the likely global commodity trends over the next two fiscals.

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Oil and gas sector steps up on clean energy transition in 2023

GREEN PUSH. Major energy players aim for net zero, embrace renewables and EVs

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COMING CLEAN. Storage tanks of an oil refinery of Essar Oil, which runs the second biggest private sector refinery, are pictured in Vadinar in West Gujarat. The World Energy Outlook 2023 points out that transitioning to clean energy sources means that every dollar of value added by the industry will result in 30% less CO_2 by 2030 REUTERS

Even as India was busy during 2023 securing the critical crude oil and natural gas supplies amidst an international market riled by sanctions and geopolitical conflicts, the year was marked by the world's third largest energy consumer's efforts to accelerate its transition to cleaner fuels, particularly for the oil and gas sector.

The upstream and downstream behemoths such as Oil and Natural Gas Corporation (ONGC), Reliance Industries (RIL), Indian Oil Corporation (IOCL), etc focused on net zero targets and plans for establishing solar and wind power capacities along with expanding into EV charging, green hydrogen and green ammonia production.

Even though India's appetite for fossil fuels is not expected to slow down any time soon, the push by oil and gas majors towards adopting clean energy sources such as renewable energy (RE), green hydrogen, e-mobility, etc will have a bearing on its energy mix by the end of this decade with renewables and electric vehicles (EVs) leading the charge.

Summing up the current global sentiment around energy, S&P Global Commodity Insights Climate & Energy Transformation Lead Simon Thorne said: "While the security of oil and gas supply will remain paramount to many countries, the world is focusing more and more on securing source materials for clean energy technology, battery metals and renewables."

CLEAN ENERGY PUSH

Avaada Group Chairman Vineet Mittal emphasises that rising consumer consciousness towards the environment and countries setting up net zero emission targets make it critical for companies in the hydrocarbon value chain to diversify business models to include clean and sustainable energy sources. The World Energy Outlook 2023 points out that transitioning to clean energy sources for India means that every dollar of value added by the industry results in 30 per cent less CO2 by 2030 than it does today and each kilometre driven by a passenger car, on average, emits 25 per cent less CO2.

JM Financial in a September 21 report said RIL aims to achieve Net Zero by 2035, followed by ONGC by 2038.

Similarly, Hindustan Petroleum Corporation (HPCL), Bharat Petroleum Corporation (BPCL), Oil India and GAIL by 2040, while IOCL aims to achieve the same by 2046. The findings, which are based on annual and sustainability reports for FY23, point towards investments being firmed up by the oil and gas firms.

For instance, RIL in its FY23 annual report highlighted its readiness to double its committed clean energy capex of ₹75,000 crore for 3 years, while the government has budgeted infusing ₹30,000 crore in IOCL, BPCL and HPCL in FY24 for clean energy projects, the brokerage added.

"Clean energy transition is not a short-term activity, rather it will take a few decades, however, oil and gas companies can accelerate it. Oil and gas majors have deep experience of raising capital along with the ability to maintain strong balance sheets, so it is not difficult for them to fund innovative new energy businesses," Mittal told *businessline*.

As the RE market is growing and will require a more robust infrastructure for supply chains, their expertise in managing complicated global supply chains, optimising assets and mastering delivery logistics will be an added advantage, he added.

In this direction, he feels that a carbon credit trading scheme, green credit programme, PLI for solar module manufacturing, the launch of the National Green Hydrogen Mission and the decision to transition away from fossil fuels at COP28, which appeared (for) first time in COP's formal outcome in 30 years, are key developments in 2023.

2024 HOLDS THE KEY

Mittal expects that the pressing issues decelerating the pace of energy transition will be addressed in 2024.

"One pressing challenge lies in land acquisition. Securing vast expanses for solar and wind farms remains a formidable task. Complex land acquisition processes, fragmented holdings, and regulatory complexities impede project development, underscoring the need for streamlined procedures," he added.

Mittal emphasised that higher cost of funding poses a hurdle. Elevated financing costs deter widespread adoption of renewable technologies, sdiscouraging potential investors. Addressing this financial barrier is pivotal and warrants strategic intervention.