Sharekhan
by BNP PARIBAS

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Indraprastha Gas Limited

Better times lie ahead

Oil & Gas	Sharekhan code: IGL	Company Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 507**	
Price Target: **Rs. 585**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 35,508 cr
52-week high/low:	Rs. 534/285
NSE volume: (No of shares)	37.1 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	21.3
DII	17.4
Others	16.3

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.8	30.2	14.1	20.3
Relative to Sensex	-1.5	7.4	-19.4	5.3

Sharekhan Research, Bloomberg

Summary

- Volumes bouncing back to 97% of pre-COVID levels, high gross margin of Rs13.7/scm (potential increase of 12.2% y-o-y in H2FY21), rupee appreciation and better operating leverage would drive to 27%/23%y-o-y growth in EBITDA/PAT in H2FY21.
- Long-term volume growth outlook remains intact given regulatory push and ramp-up of volumes in new GAs. The management expects volumes to reach 10 mmscmd over next 5 years, which implies a 12% volume CAGR over FY20-FY24E.
- We do not see any meaningful volume risk from competition as open-access regulations exclude OMCs as third-party. This removes a major overhang for CGD players, and the focus would shift back to volume and margin growth.
- We maintain a Buy on IGL with a revised PT of Rs. 585 as volume growth would support strong PAT CAGR of 20% over FY21E-FY23E with a RoE of ~21%. Robust volume growth track-record justifies premium valuation of 24.6x its FY23E EPS.

Indraprastha Gas Limited's (IGL) gas sales volume has recovered to 97% of pre-COVID-19 level as compared to 84% in Q2FY2021 even though school & office buses are still not operating. Moreover, the management expects 10-15% y-o-y volume growth in Q4FY2021 with resumption of offices in the NCR region, which would mean a 3-5% y-o-y volume growth in H2FY2021. We expect IGL's high gross margin of Rs13.7/scm would sustain in H2FY2021 supported by weak domestic gas prices (lowered by 25% to $1.79/mmBtu for H2FY2021), recent appreciation of Indian rupee and improved operating leverage as volume recovered close to pre-COVID-19 level. Hence, we expect a strong 27%/23% y-o-y growth in EBITDA/PAT to Rs. 975 crore/Rs. 659 crore in H2FY2021 for IGL. The company's management has guided for 15-20% y-o-y volume growth in FY2022 and expects volume to reach 10 mmscmd over next 5 years, which implies 12% volume CAGR over FY2020-FY2024E. Moreover, the key overhang of open access for CGD players is also over now as PNGRB's recent notification for third-party access has explicitly excluded oil marketing companies (OMCs) as third-party. Thus we so not expect any meaningful competition for CGD players in their existing GAs. Hence, we maintain our Buy rating in IGL with a revised price target of Rs. 585 as volume growth would support strong PAT CAGR of 20% over FY2021E-FY2023E along with RoE of 21%. At the CMP, the stock is trading at 27.2x its FY2022E EPS and 24.6x its FY2023E EPS.

Our Call

Valuation – Maintain Buy on IGL with a revised PT of Rs. 585: We have fine-tuned our FY2021 earnings estimate but have increased FY2022-FY2023 earnings estimates to factor in higher volume growth as we expect volume to normalised by Q3FY2021 end versus earlier expectation of Q4FY2021. The government's focus to cracking down upon polluting industrials belts and aim to increase share of gas to 15% of overall energy mix by 2025 (versus 6% currently) bodes well for sustained volume growth of CGD players. We expect IGL to outpace industry growth rate, driven by sustained high growth in existing geographical areas (GAs), expansion into new GAs of Rewari, Karnal, and Gurugram and development of three new GAs (won under the 10th CGD bidding round). Hence, we maintain our Buy rating on IGL with a revised PT of Rs. 585 (rollover of valuation multiple to FY2023E EPS and upward revision in earnings). At the CMP, the stock is trading at 27.2x its FY2022E EPS and 24.6x its FY2023E EPS, which is at a premium valuation to CGD peers, supported by superior volume growth track record.

Key risk

Lower-than-expected gas sales volume in case of COVID-19 led slowdown. Delay in development of new GAs, sharp rise in LNG prices, and adverse regulatory changes could impact outlook and valuations.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	5,765	6,485	5,038	6,271	7,029
OPM (%)	21.8	23.4	29.1	30.4	29.9
Adjusted PAT	787	1,137	999	1,306	1,445
% YoY growth	17.3	44.5	-12.1	30.8	10.6
Adjusted EPS (Rs.)	11.2	16.2	14.3	18.7	20.6
P/E (x)	45.1	31.2	35.6	27.2	24.6
P/B (x)	8.6	7.0	6.2	5.4	4.8
EV/EBITDA (x)	27.8	21.9	23.1	17.5	15.3
RoNW (%)	20.6	24.7	18.6	21.4	20.7
RoCE (%)	29.5	29.1	23.6	27.3	26.5

Source: Company; Sharekhan estimates

Volume recovered close to pre-COVID level, sustainable high margins to result in strong y-o-y earnings growth in H2FY2021

IGL's management has indicated that gas volumes volume has recovered to ~97% of pre-COVID-19 as compared to 83.6% in Q2FY2021. The recovery is commendable as school & office buses (accounting for 13% of CNG sales volumes) are still off roads and volume was also impacted due to recent farmer agitation in the NCR. Thus, the solid volume recovery clearly indicates steady rise in the CNG vehicles in NCR and the management is quite optimistic of 10-15% volume growth in Q4FY2021 with partial resumption of offices. This means 3-5% y-o-y growth in overall sales volume in H2FY2021.

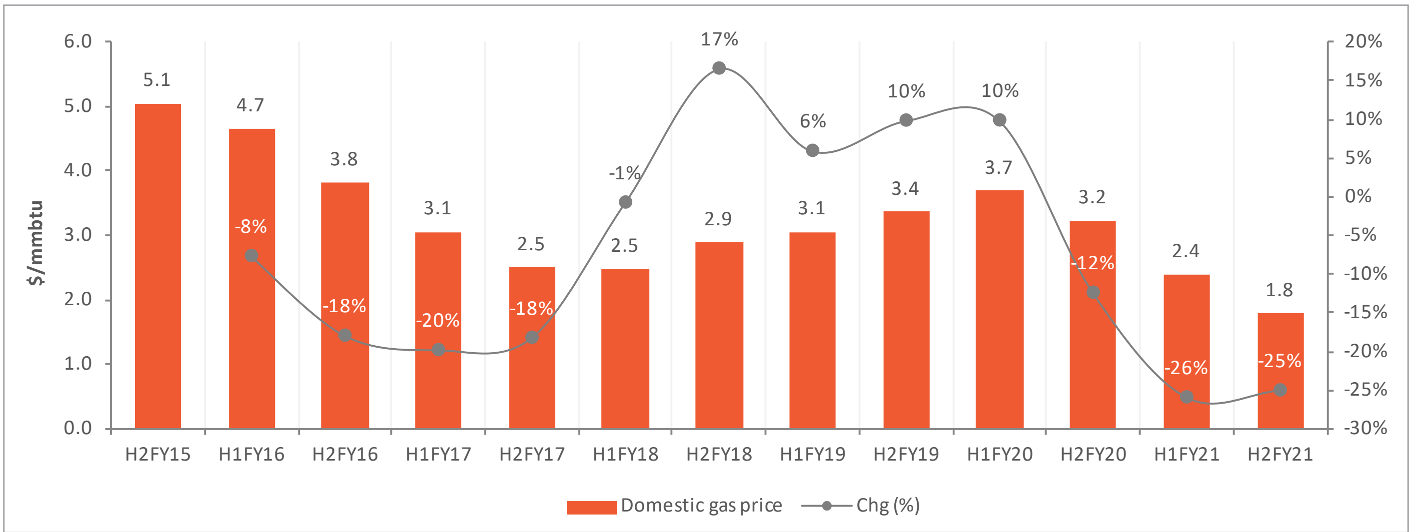
Moreover, IGL's gross margin has improved substantially by 19% y-o-y to Rs. 13.7/scm in H1FY2021. We expect high margin to sustain or could even improve in H2FY2021 given ability of IGL to retain some portion of weak domestic gas price ($1.79/mmBtu) and recent appreciation of Indian rupee (1% appreciation versus average of Q2FY2021 and 3.3% since July 2020). This coupled with focus on cost rationalization and benefit of operating leverage would result sharply higher EBITDA margin of Rs8.2/scm (a potential increase of 26.6% y-o-y). Hence, we expect a sharp 27%/23% y-o-y growth in EBITDA/PAT to Rs. 975 crore/Rs. 659 crore in H2FY2021 for IGL.

Expect strong EBITDA/PAT growth of 27%/23% y-o-y in H2FY2021E

Particulars	H2 FY2021E	H2 FY2020	y-o-y growth	Comments
Gas sales volume (mmscm)	1,185	1,183	0.2%	Assume flat volume despite management guidance of 3-5% y-o-y growth
Gross margin (Rs/scm)	13.7	12.3	12.2%	Gross margin similar to H1FY21 level despite 3.3% appreciation of Indian rupee
EBITDA Margin (Rs/scm)	8.2	6.5	26.6%	Operating leverage to result in strong margin expansion
EBITDA (Rs crore)	975	769	26.9%	
PAT (Rs crore)	659	537	22.6%	

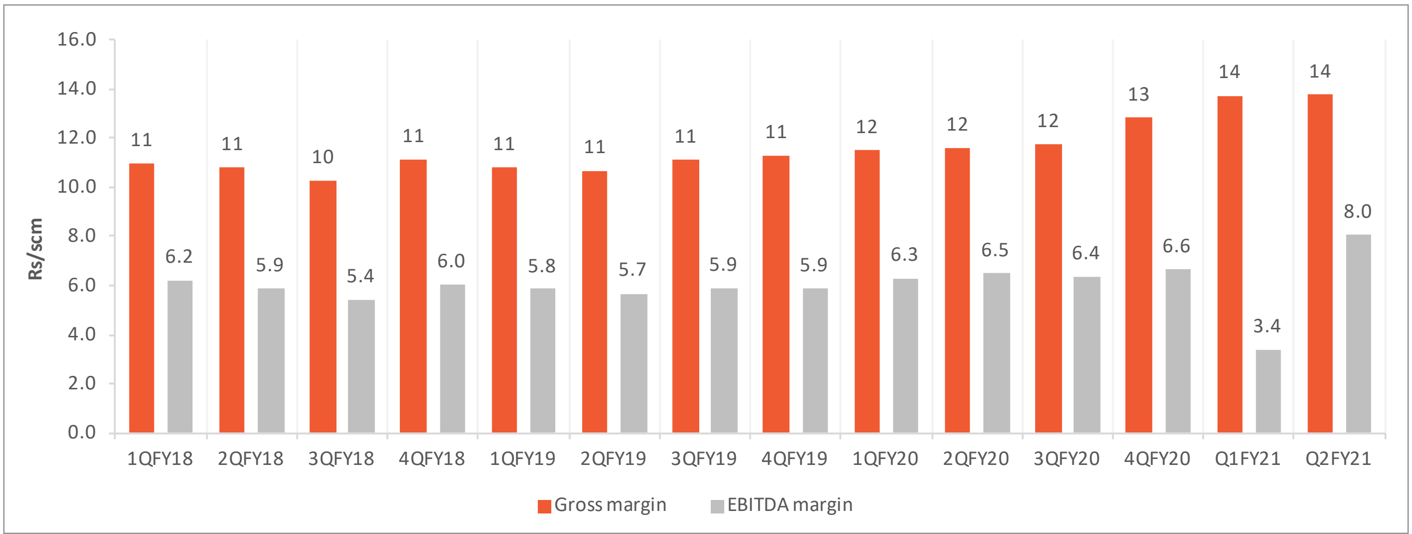
Source: Company; Sharekhan estimates

Sharp downward revision of 65% in domestic gas price to $1.8/mmBtu since H2FY15 bodes well for margin



Source: PPAC India; Sharekhan Research

IGL's margin has consistently improved given pricing power in CNG business



Source: Company; Sharekhan Research

CNG economics remain favourable versus petrol and diesel

Particulars	Petrol Car	Diesel Car	Diesel Bus
Price (Rs/litre)	84	74	74
Mileage (kms/litre)	12	16	4
Running cost (Rs/km)	7.0	4.6	18.5
CNG (Rs/kg)	43	43	43
Mileage (kms/kg)	16	16	4.5
Running cost (Rs/km)	2.7	2.7	9.5
Savings	**62%**	**42%**	**49%**
Kit cost (in Rs)	35,000	1,25,000	3,00,000
Saving per year (in Rs)	77,528	35,066	4,84,845
Payback period (in years)	0.5	3.6	0.6

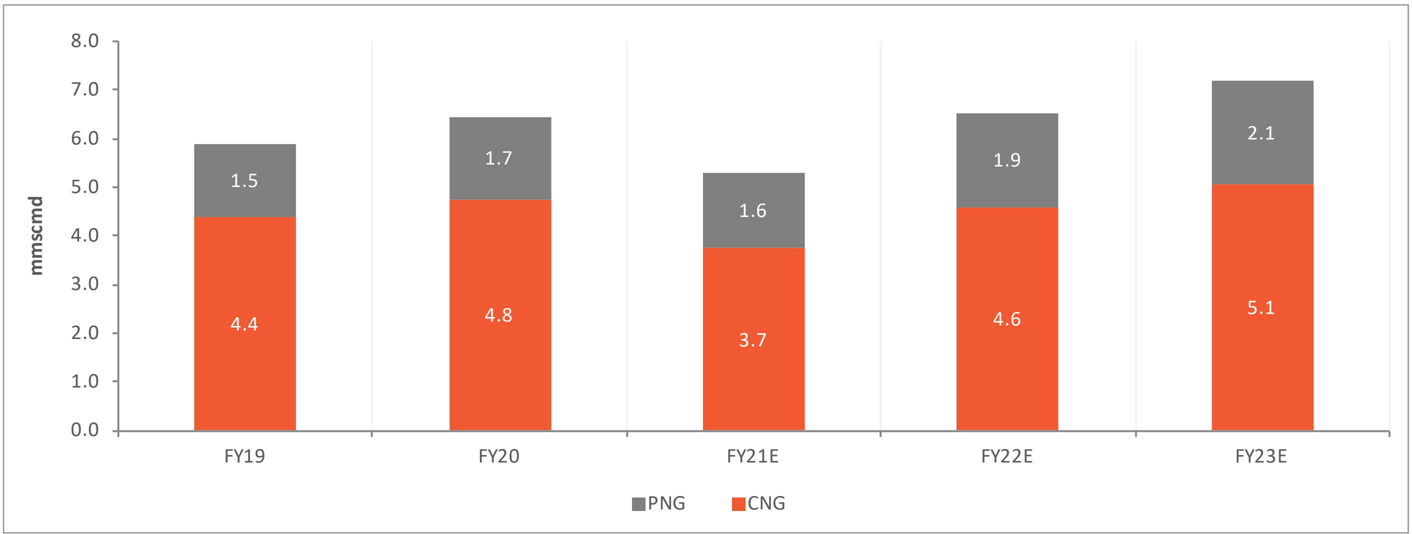
Source: Sharekhan estimates

Long term growth prospects intact with volume guidance of 10mmscmd over next 5 years

The management has guided for volume growth of 15-20% for FY2022 on low base of FY2021 (due to impact of COVID-19 in H1FY2021). Over next 5 years, the management expects volume to reach 10 mmscmd from 6.5mmscmd in FY2020, which implies a 12% CAGR over FY2020-FY2024E. Volume growth would be driven by addition of new domestic PNG connections (6 lakh annually with consumption potential of 0.3 mmscmd of gas), addition of new CNG vehicles and deeper penetration in industrial PNG. We believe that IGL's volume growth would remain strong given regulatory push to curb pollution and favourable economics of CNG versus petrol would help sustain margins.

Recently, the Air Quality Panel has asked all industrial units in Delhi to switch over to industrial PNG by January 31, 2021. We highlight here that there not much demand for industrial PNG in Delhi but within NCR region there is potential gas demand of 0.8mmscmd (50% of which is already captured in IGL's industrial PNG volume which has almost doubled over FY17-FY20). The move is directionally positive for IGL and is expected to improve investor sentiments.

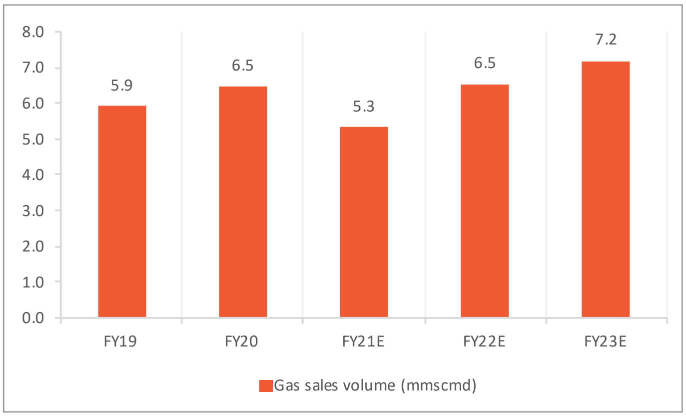
High share of CNG at 70-72% in overall volumes; expect 16% volume CAGR over FY21E-FY23E



Source: Company; Sharekhan Research

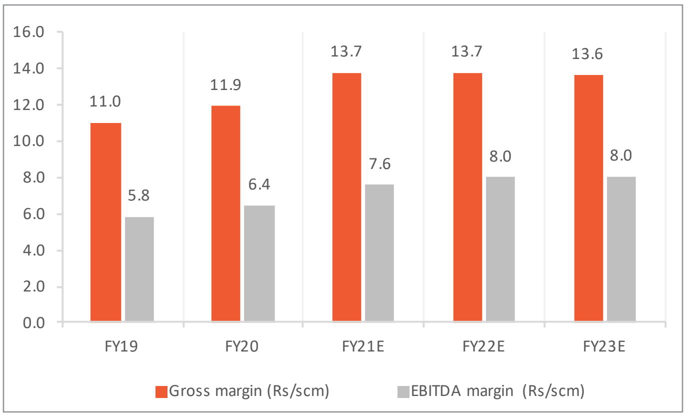
Financials in charts

Regulatory push to drive volumes



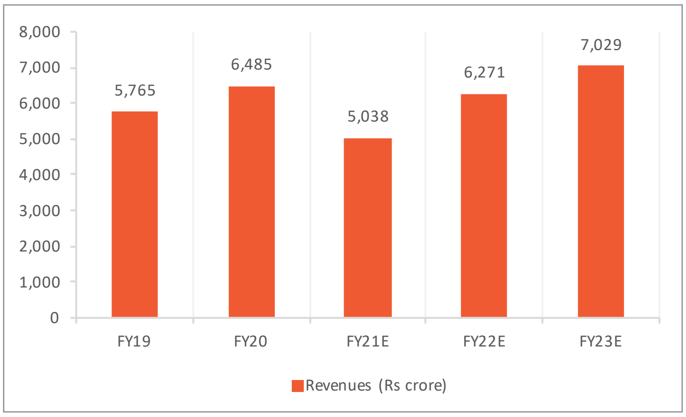
Source: Company, Sharekhan Research

Cheap domestic gas to keep margins high



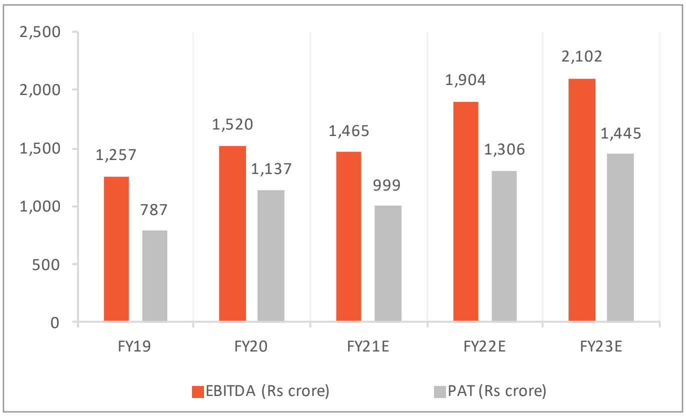
Source: Company, Sharekhan Research

Revenue trend



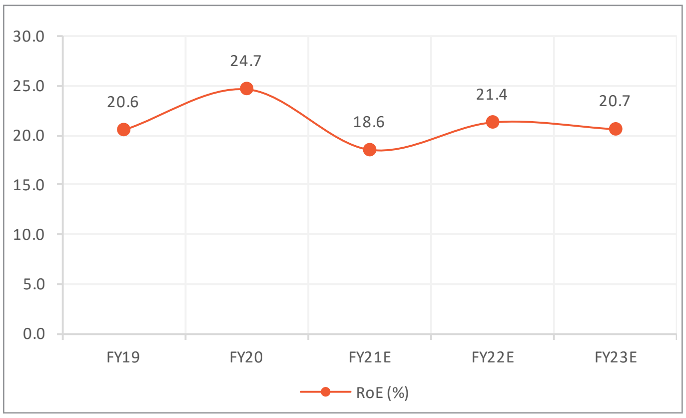
Source: Company, Sharekhan Research

EBITDA/PAT to report 20% CAGR over FY21E-FY221E



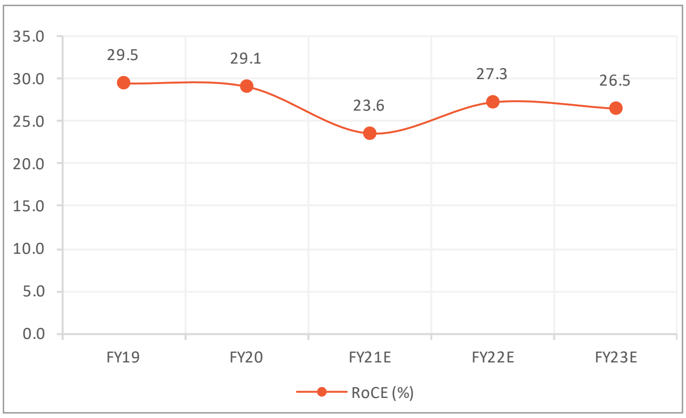
Source: Company, Sharekhan Research

Strong RoE trend



Source: Company, Sharekhan Research

RoCE to stay healthy



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Regulatory push to drive gas demand in India and benefit CGD players

Long-term gas demand potential for India is very strong, given regulatory support to curb pollution and low domestic gas prices. Additionally, the government's aim to increase share of gas in India's overall energy mix to 15% by 2025 (from 6% currently) would substantially improve gas penetration in the country and boost gas consumption. Thus, we expect sustainable high single digit growth in India gas demand for the next 4-5 years. Margins of CGD companies (with exposure towards CNG) are expected to remain strong given weak domestic gas prices.

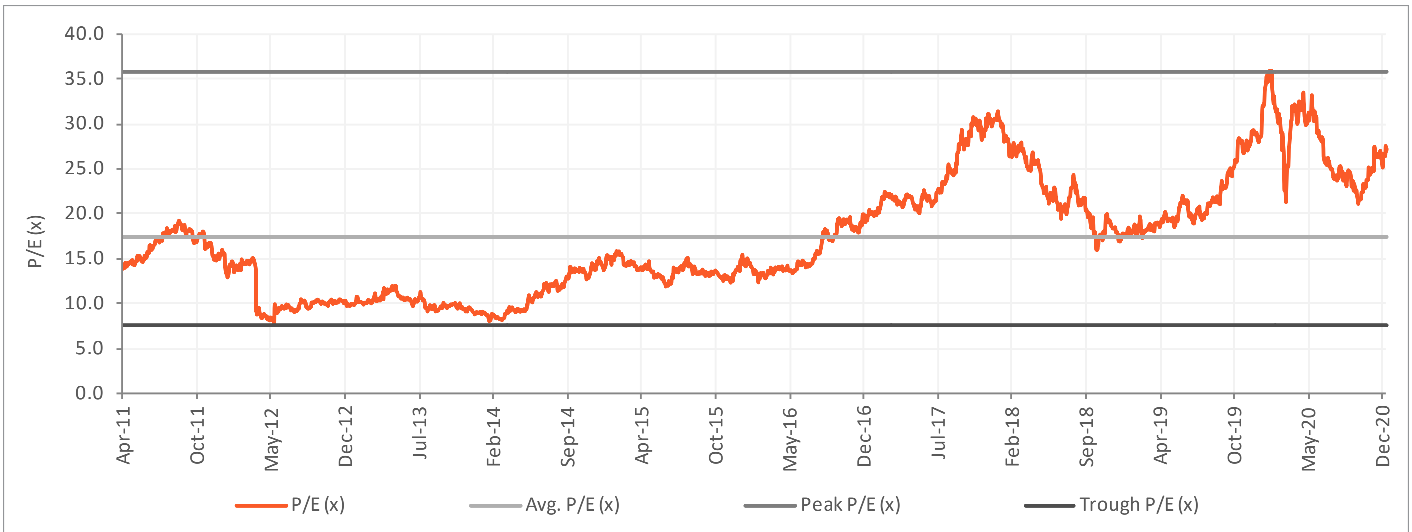
■ Company Outlook – Expect volume recovery to drive earnings growth

Sharp recovery in CNG volumes to 97% of pre-COVID-19 level and volume ramp up in new GAs, is expected to improve IGL's volume and earnings visibility. Although overall gas sales volume would decline in the current fiscal, the low base of FY2021 would mean strong a recovery in earnings over FY2022E-FY2023E. Moreover, margins have structural levers in the form of lower domestic gas prices and are expected to improve to Rs. 7.8-7.9/scm over FY2022E-FY2023E.

■ Valuation – Maintain Buy on IGL with a revised PT of Rs 585

We have fine-tuned our FY2021 earnings estimate but have increased FY2022-FY2023 earnings estimates to factor in higher volume growth as we expect volume to normalised by Q3FY2021 end versus earlier expectation of Q4FY2021. The government's focus to cracking down upon polluting industrials belts and aim to increase share of gas to 15% of overall energy mix by 2025 (versus 6% currently) bodes well for sustained volume growth of CGD players. We expect IGL to outpace industry growth rate, driven by sustained high growth in existing geographical areas (GAs), expansion into new GAs of Rewari, Karnal, and Gurugram and development of three new GAs (won under the 10th CGD bidding round). Hence, we maintain our Buy rating on IGL with a revised PT of Rs. 585 (rollover of valuation multiple to FY2023E EPS and upward revision in earnings). At the CMP, the stock is trading at 27.2x its FY2022E EPS and 24.6x its FY2023E EPS, which is at a premium valuation to CGD peers, supported by superior volume growth track record.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

IGL is a dominant CGD player in NCR (Delhi, Noida, Greater Noida, and Ghaziabad), with gas sales volume of 6.5 mmscmd in FY2020. IGL derives 74% of its volume from CNG, 14% from domestic PNG (including sales to other CDG companies), and remaining from commercial/industrial PNG. The entire gas requirement for CNG and domestic PNG is met through domestic gas supply and the remaining is met through imported re-gasified liquefied natural gas (R-LNG).

Investment theme

The government's aim to increase the share of gas in India's energy mix to ~15% by 2025 (from 6% currently) and the thrust to reduce air pollution in NCR region provide a regulatory push for strong growth in CNG and domestic PNG volumes for IGL. Moreover, the development of new GAs of Rewari, Karnal, and Gurugram and recent awarding of three new GAs in the 10th round of CGD bidding would drive volume growth beyond its existing areas of operations. The company's margins are expected to remain strong, given domestic gas prices. Moreover, recent sharp CNG recovery indicates normalisation of overall volume much faster than expectation.

Key Risks

- Lower-than-expected gas sales volume in case of delay in volume recovery due to COVID-19 led demand slowdown.
- Any change in domestic gas allocation policy, depreciation of Indian rupee, and any adverse regulatory changes could affect margins and valuations.

Additional Data

Key management personnel

PK Gupta	Chairman
AK Jana	Managing Director
Manjeet Singh Gulati	Director - Finance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.5
2	FMR LLC	3.1
3	Kotak Mahindra Asset Management Co	2.9
4	VONTOBEL FUND	2.4
5	Vontobel Holding AG	2.4
6	Vanguard Group Inc	1.8
7	HDFC Life Insurance Company Limited	1.3
8	BlackRock Inc	1.2
9	Schrodes Intl Selection Fund	1.2
10	Schrodes Plc	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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