Sharekhan by BNP PARIBAS

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Stock Update

Indraprastha Gas Limited

Strong margin performance; multiple levers for volume growth

Oil & Gas	Sharekhan code: IGL	Result Update

Summary

- Q3FY2021 operating profit stood at Rs. 501 crore, up 27.8% y-o-y and 2% ahead of our estimates as beat in EBITDA margin at Rs. 8.7/scm (up 36.7% y-o-y) was partially offset by slight miss in gas sales volume at 6.3mmscmd (up 13.8% q-o-q).
- Sharp recovery in CNG volume to 91% of pre-COVID-19 level to 4.5mmscmd, while domestic and I/C PNG volume grew by 14% and 2% y-o-y respectively. Robust gross margin at Rs14.6/scm (up 24.1% y-o-y).
- High EBITDA margin to sustain over FY2022-FY2023E, given ability to pass any rise in APM gas price; volume growth (guidance of 12% CAGR over FY20-FY24E) to outpace the industry's growth led by high gas demand in in existing GAs and ramp-up volume at new GAs.
- We maintain Buy on Indraprastha Gas Limited (IGL) with a revised PT of Rs. 650 given strong earnings growth outlook and high RoE of 22%-23%. Robust volume growth track-record justifies premium valuation of 24.4x its FY2023E EPS.

Indraprastha Gas Limited's (IGL) Q3FY2021 operating profit at Rs. 501 crore (up 27.8% y-o-y; up 23% q-o-q) was marginally ahead of our and street estimates as better-than-expected EBITDA margin of Rs. 8.7/scm (up 36.7% y-o-y; up 8% q-o-q) was partially offset by slight miss in gas sales volume at 6.3mmscmd (down 6.5% y-o-y; up 13.8% q-o-q)). CNG volume witnessed a sharp recovery to 91% of pre-COVID-19 level versus 80% in Q2FY2021 and domestic PNG volume grew by 14% y-o-y to 0.45mmscmd. Industrial/commercial (I/C) PNG volume was also up by 2% y-o-y to 0.91mmscmd. The improvement in EBITDA margin was led by 24.1% y-o-y and 6% q-o-q expansion in gross margin to Rs. 14.6/scm, given benefit of cut in domestic gas price. PAT at Rs. 335 crore (up 18% y-o-y; up 8.7% q-o-q) was slightly lower than our estimate of Rs. 339 crore, as beat in margin was offset by lower other income (down 49% y-o-y). We expect IGL's high gross/EBITDA margin to sustain and could even improve over FY2022E-FY2023E, given pricing power in the CNG business, recent appreciation of Indian Rupee, and improved operating leverage as volume recovered close to pre-COVID-19 level. The volume growth outlook remains robust with expectation of high double-digit growth in FY2022 (on low base of FY2021). Management expects volume to reach 10 mmscmd over the next five years, which implies a robust 12% volume CAGR over FY2020-FY2024E. We remain confident of strong earnings growth and expect a 24%/25% EBITDA/PAT CAGR over FY2021E-FY2023E for IGL. Hence, we maintain our Buy rating on IGL with a revised price target (PT) of Rs. 650. At the CMP, the stock is trading at 27.1x its FY2022E EPS and 24.4x its FY2023E EPS.

Key positives

- Better-than-expected gross/EBITDA margin at Rs. 14.6/Rs. 8 per scm, up 24.1%/36.7% y-o-y, led by benefit of lower domestic gas prices.
- High growth of 14% y-o-y in domestic PNG volume to 0.45mmscmd.

Key negatives

- Depreciation increased sharply by 16.9% y-o-y in Q3FY2021.

Our Call

Valuation – Maintain Buy on IGL with a revised PT of Rs. 650: We have increased our FY2021-FY2023 earnings estimates to factor in higher gross margin assumption, as we expect high margin to sustain given pricing power for CNG (74% of overall volumes historically). Moreover, we expect IGL to outpace the industry's volume 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). Overall, we expect a strong CAGR of 24%/25% in EBITDA/PAT over FY2021E-FY2023E. Hence, we maintain our Buy rating on IGL with a revised PT of Rs. 650 (reflects upward revision in earnings). At the CMP, the stock is trading at 27.1x its FY2022E EPS and 24.4x its FY2023E EPS, which is at a premium to valuation of CGD peers, given superior volume growth track record and high share of CNG in the volume mix.

Key risk

Lower-than-expected gas sales volume in case of delayed recovery due to 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
Revenue	5,765	6,485	4,904	6,255	7,012
OPM (%)	21.8	23.4	30.8	33.2	32.9
Adjusted PAT	787	1,137	1,031	1,438	1,598
% YoY growth	17.3	44.5	-9.3	39.4	11.2
Adjusted EPS (Rs.)	11.2	16.2	14.7	20.5	22.8
P/E (x)	49.5	34.3	37.8	27.1	24.4
P/B (x)	9.4	7.7	6.8	5.9	5.1
EV/EBITDA (x)	30.5	24.2	24.7	17.7	15.3
RoNW (%)	20.6	24.7	19.1	23.3	22.4
RoCE (%)	29.5	29.1	24.3	29.7	28.7

Source: Company; Sharekhan estimates

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. 557**	
Price Target: **Rs. 650**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 38,973 cr
52-week high/low:	Rs. 581/285
NSE volume: (No of shares)	35.0 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	23.2
DII	16.1
Others	15.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-0.2	24.1	43.0	10
Relative to Sensex	-4.3	6.4	9.4	-15

Sharekhan Research, Bloomberg

Marginal beat in operating profit as higher margin gets partially offset by slight miss in gas sales volume: IGL's Q3FY2021 operating profit at Rs. 501 crore (up 27.8% y-o-y; up 23% q-o-q) was marginally ahead of our and street estimates as better-than-expected EBITDA margin of Rs. 8.7/scm (up 36.7% y-o-y; up 8% q-o-q) was partially offset by slight miss in gas sales volume at 6.3mmscmd (down 6.5% y-o-y; up 13.8% q-o-q)). CNG volume witnessed a sharp recovery to 91% of pre-COVID-19 level versus 80% in Q2FY2021 and domestic PNG volume grew by 14% y-o-y to 0.45mmscmd. Industrial/commercial (I/C) PNG volume was also up by 2% y-o-y to 0.91mmscmd. The improvement in EBITDA margin was led by 24.1% y-o-y and 6% q-o-q expansion in gross margin to Rs. 14.6/scm, given benefit of cut in domestic gas price. PAT at Rs. 335 crore (up 18% y-o-y; up 8.7% q-o-q) was slightly lower than our estimate of Rs. 339 crore, as beat in margin was offset by lower other income (down 49% y-o-y).

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Net Sales	**1,446**	**1,664**	**-13.1**	**1,305**	**10.8**
Total Expenditure	945	1,272	-25.7	898	5.3
Reported operating profit	501	392	27.8	407	23.0
Adjusted operating profit	**501**	**392**	**27.8**	**407**	**23.0**
Other Income	26	51	-49.0	66	-60.6
EBITDA	527	443	19.0	473	11.4
Interest	3	2	51.7	2	33.2
Depreciation	75	64	16.9	71	5.5
Exceptional income/(expense)	0	0	-	0	-
Reported PBT	449	376	19.2	399	12.3
Adjusted PBT	**449**	**376**	**19.2**	**399**	**12.3**
Tax	114	93	22.8	91	24.2
Reported PAT	335	284	18.0	308	8.7
Adjusted PAT	**335**	**284**	**18.0**	**308**	**8.7**
Equity Cap (cr)	70	70	-	70	-
Reported EPS (Rs.)	4.8	4.1	18.0	4.4	8.7
Adjusted EPS (Rs.)	4.8	4.1	18.0	4.4	8.7
Margins (%)			**BPS**		**BPS**
Adjusted OPM	34.6	23.5	1107.7	31.2	343.4
Adjusted NPM	23.2	17.1	609.9	23.6	-43.3

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Total gas sales volume (mmscmd)	6.3	6.7	-6.5	5.5	13.8
EBITDA margin (Rs./scm)	8.7	6.4	36.7	8.0	8.0
CNG volume (mmscmd)	4.5	4.9	-8.8	3.9	14.4
PNG volume (mmscmd)	1.8	1.8	0.0	1.6	12.3

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Regulatory push and low gas price 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 the 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.

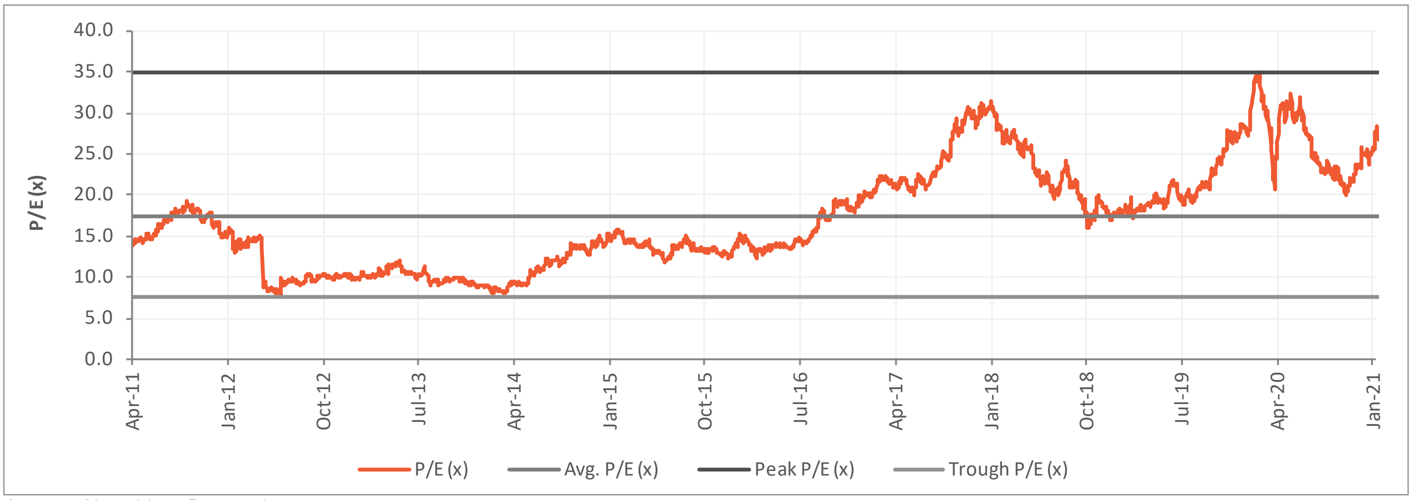
■ Company Outlook – Expect strong Q4FY2021; Long-term volume growth outlook intact

Sharp recovery in CNG volumes to 91% of pre-COVID-19 level is expected to reach normalised level in Q4Y202021, which would lead to strong earnings growth IGL in Q4FY2021. Additionally, long-term volume growth outlook remains strong (supported by ramp-up of new GAs and higher industrial PNG demand) and margin is expected to sustain at elevated level, given the ability to pass on any increase in domestic gas price given favourable economics of CNG versus petrol. Hence, we expect a strong EBITDA/PAT CAGR of 24%/25% over FY2021E-FY2023E along with RoE of 22%-23%.

■ Valuation – Maintain Buy on IGL with a revised PT of Rs. 650

We have increased our FY2021-FY2023 earnings estimate to factor in higher gross margin assumption as we expect the current level of margin to sustain, given pricing power for CNG (74% of overall volume historically). We expect IGL to outpace the industry's volume growth rate, driven by sustained high growth in existing 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. 650 (reflects upward revision in earnings). At the CMP, the stock is trading at 27.1x its FY2022E EPS and 24.4x its FY2023E EPS, which is at a premium to valuation of CGD peers, given superior volume growth track record and high share of CNG in volume mix.

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 the 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, the 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.
- Overhang on CGD stocks will stay until the open access regulations are finalised by PNGRB.

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	9.6
2	Republic of India	5.0
3	FMR LLC	3.2
4	Kotak Mahindra Asset Management Co	2.7
5	VONTOBEL FUND	2.4
6	Vontobel Holding AG	2.4
7	Vanguard Group Inc/The	1.8
8	BlackRock Inc	1.2
9	FundRock Management Co SA	0.8
10	Impax Asset Management Ltd	0.7

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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