Sharekhan by BNP PARIBAS

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Stock Update

Indraprastha Gas Limited

Mixed Q4; recent under-performance offers investment opportunity

Oil & Gas	Sharekhan code: IGL	Result 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. 512**	
Price Target: **Rs. 650**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

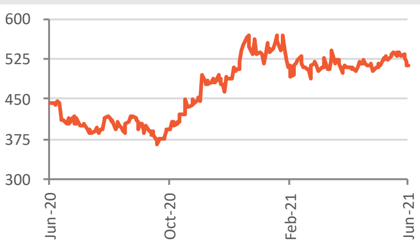
Company details

Market cap:	Rs. 35,872 cr
52-week high/low:	Rs. 595 / 364
NSE volume: (No of shares)	28.7 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	23.8
DII	15.9
Others	15.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1	2	5	16
Relative to Sensex	-3	-6	-7	-35

Sharekhan Research, Bloomberg

Summary

- Q4FY21 operating profit of Rs. 492 crore (up 31% y-o-y) lagged our estimate as EBITDA margin missed estimates at Rs. 8/scm (down 7.9% q-o-q) but gas sales volume growth of 9.5% y-o-y to 6.8 mmscmd was much ahead of our/street's expectations.
- CNG/domestic-PNG/I/C PNG volumes rose strongly by 8.3%/11%/20% y-o-y; EBITDA margin declined was due to 6.5% q-o-q contraction in gross margin to Rs. 13.6/scm offsetting the benefit of an 8.9% y-o-y decline in per unit opex.
- We cut our FY22E EPS to factor lower volumes in Q1FY22 amid COVID-led lockdowns but remain confident of long-term volume growth prospects given structural gas demand drivers. IGL well placed to sustain high margin but OMCs' demand of high dealer commissions would remain a near-term overhang.
- IGL's recent underperformance to Gujarat Gas is an opportunity to invest in the stock as long-term volume/margin outlook remains intact. Hence, we a maintain a Buy on IGL with an unchanged PT of Rs. 650. At CMP, the stock trades at 22.6x its FY23E EPS.

Indraprastha Gas Limited's (IGL) Q4FY21 operating profit of Rs. 492 crore (up 30.5% y-o-y; down 1.8% q-o-q) was 6%/3% below our/consensus estimate of Rs. 522 crore/Rs. 499 crore. Operating profit missed estimates due to lower-than-expected EBITDA margin of Rs. 8/scm (up 20.5% y-o-y; down 7.9% q-o-q) as compared to our expectation of Rs. 8.8/scm, partially offset by stronger-than-anticipated gas sales volume growth of 9.5% y-o-y (up 9% q-o-q) to 6.8 mmscmd (4.1% above our estimate of 6.6 mmscmd). IGL witnessed volume growth across categories with a strong 8.3%/11%/20% y-o-y increase in CNG/domestic-PNG/Industrial-Commercial PNG volume to 4.9 mmscmd/0.5 mmscmd/1 mmscmd. The decline in EBITDA margin was due to a 6.5% q-o-q contraction in gross margin to Rs. 13.6/scm that offset the benefit of an 8.9% y-o-y decline in opex to Rs. 5.6/scm. PAT of Rs. 331 crore (up 30.6% y-o-y; down 1.2% q-o-q) was 10.4% below our estimate but in line with consensus estimates. PAT lagged our estimate due to lower margins and a 10.5% y-o-y decline in other income. The second wave of COVID-19 is likely to impact CNG volume by 20-25% in Q1FY2022 but we expect speedy recovery as vehicular traffic would improve with the easing if lockdown measures and the vaccination drive. The company's management is upbeat on volume growth and has been guiding for 10-12% volume CAGR over next 4 years and that gives us confidence with respect to long-term volume growth potential. Despite news of likely steep hike in domestic gas price, we expect CGDs players' high margins to sustain given favourable economic of CNG versus petrol. We remain confident of volume led strong earnings and expect a 26% PAT CAGR over FY2021-FY2023E for IGL. Hence, we maintain our Buy rating on IGL with an unchanged PT of Rs. 650. We highlight here that ongoing negotiation between CGDs and OMCs with regards to revision in dealer commission on CNG would remain an overhang on IGL in the near term. At CMP, the stock is trading at 25.7x its FY2022E EPS and 22.6x its FY2023E EPS.

Key positives

- Better-than-expected gas sales volume growth of 9.5% y-o-y to 6.8 mmscmd.
- Per unit opex declined sharply by 8.9% y-o-y led by benefit of operating leverage given strong volume growth.

Key negatives

- Lower-than-expected EBITDA margin at Rs. 8/scm (down 7.9% q-o-q) due to sequential contraction in gross margin.

Our Call

Valuation – Maintain Buy on IGL with an unchanged PT of Rs. 650: We have lowered our FY2022 earnings estimates to factor in lower CNG volumes due to COVID-19 related lockdown in April-May 2021 and have fine-tuned our FY2023 earnings estimates. The recent under-performance of IGL (stock price up 5% in the last six months versus 71% rise in stock price of Gujarat Gas) provides an opportunity to invest in the stock as the long-term growth outlook remains intact and the same has been well appreciated by the street historically. IGL would be key beneficiary of the structural theme of gradual shift towards gas based economy given government's thrust to increase share of gas to 15% of overall energy mix by 2025 (versus 6% currently) and cracking down upon polluting industrials belts. Overall, we expect 16% volume CAGR (led by growth in existing GAs and expansion into new GAs) and sustained high margin to drive strong earnings CAGR of 26% over FY2021-FY2023E along with high RoE of 21.8% in FY2023. Hence, we maintain a Buy rating on IGL with an unchanged PT of Rs. 650. At the CMP, the stock is trading at 25.7x its FY2022E EPS and 22.6x its FY2023E EPS.

Key Risks

Lower-than-expected gas sales volume in case of delayed recovery due to COVID-19 led slowdown. Delay in development of new GAs, a sharp rise in LNG prices and adverse regulatory changes (revision in APM gas pricing formula) could impact outlook and valuations. OMC demand of high dealer commission would remain an overhang on MGL until it is resolved.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenues	6,485	4,941	6,207	7,003
OPM (%)	23.4	30.0	33.1	33.2
Adjusted PAT	1,137	1,006	1,396	1,586
% YoY growth	*44.5*	*-11.5*	*38.8*	*13.6*
Adjusted EPS (Rs.)	16.2	14.4	19.9	22.7
P/E (x)	31.6	35.7	25.7	22.6
P/B (x)	7.1	6.1	5.3	4.6
EV/EBITDA (x)	22.2	23.4	16.7	14.5
RoNW (%)	24.7	18.4	22.1	21.8
RoCE (%)	29.1	23.1	28.0	27.9

Source: Company; Sharekhan estimates

Miss in operating profit due to lower-than-expected margin; robust volume growth of 9.5% y-o-y

IGL's Q4FY21 operating profit at Rs. 492 crore (up 30.5% y-o-y; down 1.8% q-o-q) was 6%/3% below our/consensus estimate of Rs. 522 crore/Rs. 499 crore. Operating profit missed estimates due to lower-than-expected EBITDA margin of Rs. 8/scm (up 20.5% y-o-y; down 7.9% q-o-q) as compared to our expectation of Rs. 8.8/scm, partially offset by stronger-than-anticipated gas sales volume growth of 9.5% y-o-y (up 9% q-o-q) to 6.8 mmscmd (4.1% above our estimate of 6.6 mmscmd). IGL witnessed volume growth across categories with a strong 8.3%/11%/20% y-o-y increase in CNG/domestic-PNG/Industrial-Commercial PNG volume to 4.9 mmscmd/0.5 mmscmd/1 mmscmd. The decline in EBITDA margin was due to a 6.5% q-o-q contraction in gross margin to Rs. 13.6/scm that offset the benefit of an 8.9% y-o-y decline in opex to Rs. 5.6/scm. PAT of Rs. 331 crore (up 30.6% y-o-y; down 1.2% q-o-q) was 10.4% below our estimate but in line with consensus estimates. PAT lagged our estimate due to lower margins and a 10.5% y-o-y decline in other income.

Results Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Net Sales	1,551	1,553	-0.1	1,446	7.2
Total Expenditure	1,059	1,176	-9.9	945	12.0
Reported operating profit	492	377	30.5	501	-1.8
Adjusted operating profit	**492**	**377**	**30.5**	**501**	**-1.8**
Other Income	28	31	-10.5	26	8.0
EBITDA	520	408	27.4	527	-1.3
Interest	4	3	36.0	3	19.0
Depreciation	76	66	16.2	75	1.5
Exceptional income/(expense)	0	0		0	
Reported PBT	440	340	29.5	449	-1.9
Adjusted PBT	**440**	**340**	**29.5**	**449**	**-1.9**
Tax	109	86	26.0	114	-4.1
Reported PAT	331	253	30.6	335	-1.2
Adjusted PAT	**331**	**253**	**30.6**	**335**	**-1.2**
Equity Cap (cr)	70	70		70	
Reported EPS (Rs.)	4.7	3.6	30.6	4.8	-1.2
Adjusted EPS (Rs.)	4.7	3.6	30.6	4.8	-1.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	31.7	24.3	744.7	34.6	-290.7
Adjusted NPM	21.3	16.3	502.8	23.2	-181.0

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Total volume (mmscmd)	6.8	6.2	9.5	6.3	9.0
EBITDA margin (Rs. /scm)	8.0	6.6	20.5	8.7	-7.9
CNG volume (mmscmd)	4.9	4.5	8.3	4.5	8.7
PNG volume (mmscmd)	2.0	1.7	12.6	1.8	9.7

Source: Company; Sharekhan Research

Volume break-up by categories (figures in mmscmd)

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
CNG	4.9	4.5	8.3%	4.5	9%
PNG domestic	0.5	0.5	11.0%	0.4	12%
I/C PNG	1.0	0.8	20.0%	0.9	8%
Natural gas	0.5	0.5	1.1%	0.4	10%
Total volume	**6.8**	**6.2**	**9.5%**	**6.3**	**9%**
Volume mix (%)			**BPS**		**BPS**
CNG	71	72	-80	72	-19
PNG domestic	7	7	10	7	21
I/C PNG	14	13	127	15	-9
Natural gas	7	7	-57	7	7
Total	**100**	**100**		**100**	

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 - Q1FY22 CNG volume get impacted; Long-term volume growth outlook intact

Notwithstanding near-term lower volumes in Q1FY22, we believe that IGL is well placed to benefit from rising gas consumption in India and thus we model 16% volume CAGR over FY2021-FY2023E led by a 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). EBITDA margin is expected to stay high, given IGL's 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 246over FY2021-FY2023E.

■ Valuation - Maintain Buy on IGL with an unchanged PT of Rs. 650

We have lowered our FY2022 earnings estimates to factor in lower CNG volumes due to COVID-19 related lockdown in April-May 2021 and have fine-tuned our FY2023 earnings estimates. The recent under-performance of IGL (stock price up 5% in the last six months versus 71% rise in stock price of Gujarat Gas) provides an opportunity to invest in the stock as the long-term growth outlook remains intact and the same has been well appreciated by the street historically. IGL would be key beneficiary of the structural theme of gradual shift towards gas based economy given government's thrust to increase share of gas to 15% of overall energy mix by 2025 (versus 6% currently) and cracking down upon polluting industrials belts. Overall, we expect 16% volume CAGR (led by growth in existing GAs and expansion into new GAs) and sustained high margin to drive strong earnings CAGR of 26% over FY2021-FY2023E along with high RoE of 21.8% in FY2023. Hence, we maintain a Buy rating on IGL with an unchanged PT of Rs. 650. At the CMP, the stock is trading at 25.7x its FY2022E EPS and 22.6x its FY2023E EPS.

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 6.8 mmscmd currently. IGL derives 71% 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 delayed recovery due to COVID-19 led slowdown and delay in development of new Gas
- Any change in domestic gas allocation/pricing policy, depreciation of Indian rupee, higher spot LNG price and any adverse regulatory changes could affect margins and valuations.
- OMC demand of high dealer commission would remain an overhang on MGL until resolved

Additional Data

Key management personnel

Arun Kumar Singh	Chairman
AK Jana	Managing Director
Bimal Ram Nagar	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.1
2	Republic of India	5.0
3	FMR LLC	3.2
4	Vontobel Holding AG	2.4
5	Kotak Mahindra Asset Management Co	2.4
6	VONTOBEL FUND	2.3
7	Vanguard Group Inc/The	1.8
8	BlackRock Inc	1.3
9	Schroders PLC	1.0
10	FundRock Management Co SA	0.8

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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