Sharekhan by BNP PARIBAS

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Indraprastha Gas Ltd

Q1 volumes miss mark, long-term growth story intact

Oil & Gas	Sharekhan code: IGL	Result 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. 535**	
Price Target: **Rs. 650**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

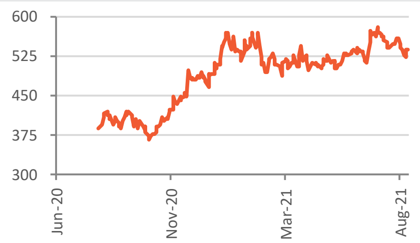
Company details

Market cap:	Rs. 37,440 cr
52-week high/low:	Rs. 595 / 364
NSE volume: (No of shares)	28.5 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	23.9
DII	14.8
Others	16.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5	5	-1	38
Relative to Sensex	-9	-9	-8	-8

Sharekhan Research, Bloomberg

Summary

- Q1FY22 PAT of Rs. 244 crore (down 26.2% q-o-q) missed our estimate due to lower-than-expected volume of 5.3 mmscmd (down 22.1% q-o-q), slight miss in EBITDA margin at Rs. 7.9/scm (down 1.7% q-o-q) and lower other income.
- CNG/Industrial-Commercial PNG/third-party sales/domestic-PNG volumes declined by 25%/18%/20%/4% q-o-q amid COVID-led lockdown; higher per unit opex offset benefit of increase in gross margins to Rs. 14.4/scm (up 5.5% q-o-q).
- Recent recovery in CNG volumes to pre-COVID levels and hike in CNG/D-PNG prices in July bodes well for strong earnings revival. Long-term volume growth outlook remains intact supported by gradual shift towards gas-based economy; management has been guiding for a 10-12% volume CAGR in the next four years.
- IGL's recent underperformance to Gujarat Gas presents an investment opportunity given strong earnings growth outlook. Hence, we maintain a Buy on IGL with an unchanged PT of Rs. 650. At CMP, the stock trades at 23.6x its FY23E EPS.

Indraprastha Gas Limited's (IGL) Q1FY2022 standalone operating profit of Rs. 381 crore (down 22.6% q-o-q) was 6% below our estimate of Rs. 405 crore due to: 1) lower-than-expected gas sales volume of 5.3 mmscmd (down 22.1% q-o-q versus expectation of a 19% q-o-q decline) and 2) slight miss in EBITDA margin at Rs. 7.9/scm (down 1.7% q-o-q) as higher operating cost (per unit opex up 15.7% q-o-q due to decline in volume) offset 5.5% q-o-q rise in gross margins to Rs. 14.4/scm. The second wave of COVID-19 hit gas sales volumes across categories with a 25%/18%/20%/4% q-o-q volume decline in CNG/Industrial-Commercial PNG/third party sales/domestic-PNG to 3.6 mmscmd/0.8 mmscmd/0.4 mmscmd/0.5 mmscmd. PAT of Rs. 244 crore (down 26.2% q-o-q) was 9% below our estimate of Rs. 268 crore due to a miss in gas sales volumes, lower-than-anticipated other income and marginally higher effective income-tax rate of 26% (versus our assumption of 25.2%). IGL's CNG volume is believed to have reached pre-COVID-19 level in July after the recent relaxation of COVID-19 restrictions on vehicle movement and overall gas sales volumes has also recovered fully. The company's management is upbeat on volume growth and has been guiding for a 10-12% volume CAGR over next 4 years and that gives us confidence with respect to long-term volume growth potential. Expansion of new GAs of Rewari, Karnal, and Gurugram, and development of three new GAs (won under the 10th CGD bidding round) could further accelerate volume growth in the coming years. We expect high EBITDA margin to sustain for CGDs players as favourable economics of CNG versus petrol would help them pass on a potential hike in domestic gas prices (50-60% rise likely from October). We remain confident of volume-led strong earnings growth and expect a 26% PAT CAGR over FY2021-FY2023E for IGL. Hence, we maintain a Buy on IGL with an unchanged PT of Rs. 650. At CMP, the stock is trading at 23.6x its FY2023E EPS and 21.3x its FY2024E EPS.

Key positives

- Better-than-expected gross margin at Rs. 14.4/scm (up 5.5% q-o-q).
- CNG/Domestic PNG price of Rs. 1/kg and Rs. 1.3/scm respectively in July 21 to support gross margins.

Key negatives

- Higher-than-anticipated effect of COVID-19 on gas sales volume with 25%/18% q-o-q decline in CNG/I/C volumes in Q1FY2022.

Our Call

Valuation – Maintain Buy on IGL with an unchanged PT of Rs. 650: We maintain our FY2022-FY2023 earnings estimate as we expect a strong volume recovery in the coming quarters and have also introduced our FY2024 earnings estimates in this report. The recent under-performance of IGL (stock price is down 1% versus 71% rise in stock price of Gujarat Gas in the last six months) provides an opportunity to invest in the stock as the long-term growth outlook remains intact supported by structural theme of gradual shift towards gas-based economy. Moreover, IGL is focused on entering the EV segment with recent announcement to set-up battery swapping stations in Delhi/NCR region in partnership other companies. Overall, we expect a 16% CAGR in volumes (led by growth in existing GAs and expansion into new GAs) and sustained high margins to drive a strong earnings CAGR of 26% over FY2021-FY2023E along with high RoE of 21.8% in FY2023E. Hence, we maintain a Buy rating on IGL with an unchanged PT of Rs. 650. At CMP, the stock is trading at 23.6x its FY2023E EPS and 21.3x its FY2024E EPS.

Key Risks

Lower-than-expected gas sales volume 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 IGL until it is resolved.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Revenues	6,485	4,941	6,207	7,003	8,022
OPM (%)	23.4	30.0	33.1	33.2	35.0
Adjusted PAT	1,137	1,006	1,396	1,586	1,756
% YoY growth	*44.5*	*-11.5*	*38.8*	*13.6*	*10.7*
Adjusted EPS (Rs.)	16.2	14.4	19.9	22.7	25.1
P/E (x)	32.9	37.2	26.8	23.6	21.3
P/B (x)	7.4	6.4	5.5	4.8	4.2
EV/EBITDA (x)	23.2	24.5	17.4	15.2	12.1
RoNW (%)	24.7	18.4	22.1	21.8	21.1
RoCE (%)	29.1	23.1	28.0	27.9	30.1

Source: Company; Sharekhan estimates

PAT missed our estimate on lower-than-expected gas sales volume and other income

Indraprastha Gas Limited's (IGL) Q1FY2022 standalone operating profit of Rs. 381 crore (down 22.6% q-o-q) was 6% below our estimate of Rs. 405 crore due to: 1) lower-than-expected gas sales volume of 5.3 mmscmd (down 22.1% q-o-q versus expectation of a 19% q-o-q decline) and 2) slight miss in EBITDA margin at Rs. 7.9/scm (down 1.7% q-o-q) as higher operating cost (per unit opex up 15.7% q-o-q due to decline in volume) offset 5.5% q-o-q rise in gross margins to Rs. 14.4/scm. The second wave of COVID-19 hit gas sales volumes across categories with a 25%/18%/20%/4% q-o-q volume decline in CNG/Industrial-Commercial PNG/third party sales/domestic-PNG to 3.6 mmscmd/0.8 mmscmd/0.4 mmscmd/0.5 mmscmd. PAT of Rs. 244 crore (down 26.2% q-o-q) was 9% below our estimate of Rs. 268 crore due to a miss in gas sales volumes, lower-than-anticipated other income and higher effective income-tax rate of 26% (versus our assumption of 25.2%).

Results (Standalone) Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Revenue	**1,257**	**639**	**96.9**	**1,551**	**-18.9**
Total Expenditure	877	555	57.9	1,059	-17.2
Operating profit	**381**	**83**	**356.4**	**492**	**-22.6**
Other Income	30	31	-2.6	28	6.6
EBITDA	411	114	260.0	520	-21.0
Interest	3	2	24.1	4	-19.0
Depreciation	78	68	14.1	76	2.2
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	330	44	658.0	440	-25.0
Tax	86	12	632.7	109	-21.4
Reported PAT	**244**	**32**	**667.2**	**331**	**-26.2**
Equity Cap (cr)	70	70		70	
Reported EPS (Rs)	3.5	0.5	667.2	4.7	-26.2
Margins (%)			**BPS**		**BPS**
OPM	30.3	13.1	1722.3	31.7	-142.4
NPM	19.4	5.0	1444.2	21.3	-191.8
Tax rate	26.0	26.9	-89.6	24.8	118.8

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Total volume (mmscmd)	5.3	2.7	95.5	6.8	-22.1
Gross margin (Rs/scm)	14.4	13.7	4.8	13.6	5.5
EBITDA margin (Rs/scm)	7.9	3.4	133.5	8.0	-1.7
CNG volume (mmscmd)	3.6	1.6	126.1	4.9	-25.1
PNG volume (mmscmd)	1.7	1.1	50.9	2.0	-14.6

Source: Company; Sharekhan Research

Volume break-up by categories **(figures in mmscmd)**

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
CNG	3.6	1.6	126.1%	4.9	-25%
PNG domestic	0.5	0.5	2.8%	0.5	-4%
I/C PNG	0.8	0.4	81.0%	1.0	-18%
Natural gas	0.4	0.2	100.2%	0.5	-20%
Total volume	**5.3**	**2.7**	**95.5%**	**6.8**	**-22%**
Volume mix			**BPS**		**BPS**
CNG	69	59	926	71	-275
PNG domestic	9	17	-819	7	174
I/C PNG	15	17	-123	14	81
Natural gas	7	7	16	7	20
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. CGD companies' (with exposure towards CNG) margins are expected to remain strong given weak domestic gas prices.

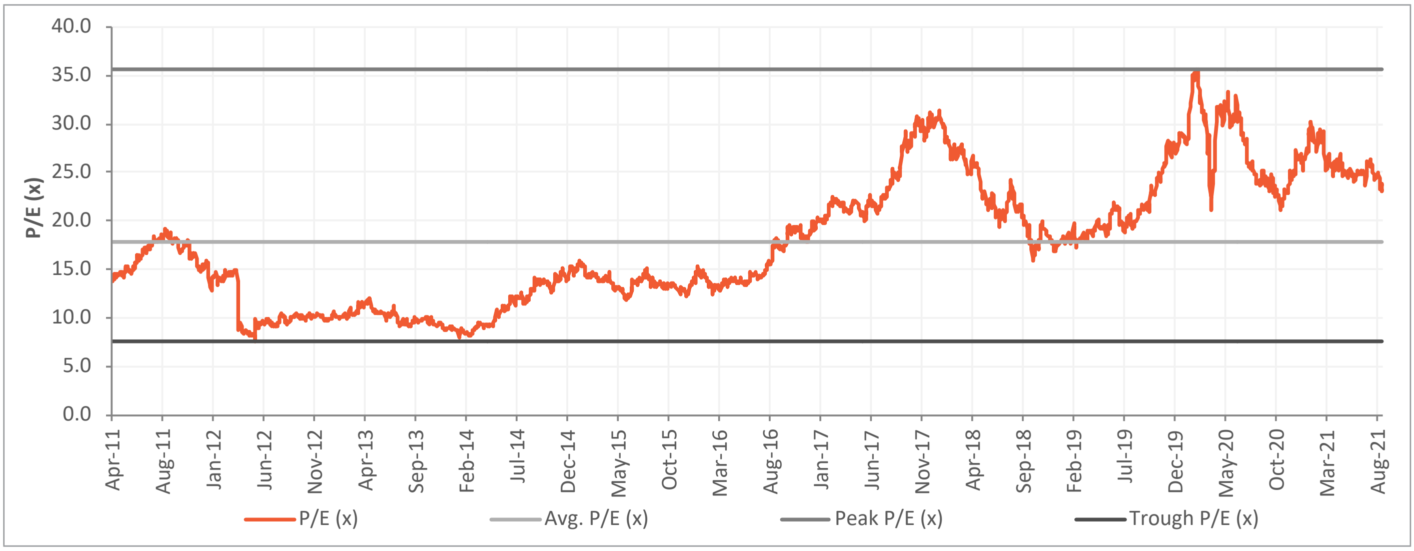
■ **Company outlook – Long-term volume growth outlook intact**

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 25%/26% over FY2021-FY2023E.

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

We maintain our FY2022-FY2023 earnings estimate as we expect a strong volume recovery in the coming quarters and have also introduced our FY2024 earnings estimates in this report. The recent under-performance of IGL (stock price is down 1% versus 71% rise in stock price of Gujarat Gas in the last six months) provides an opportunity to invest in the stock as the long-term growth outlook remains intact supported by structural theme of gradual shift towards gas-based economy. Moreover, IGL is focused on entering the EV segment with recent announcement to set-up battery swapping stations in Delhi/NCR region in partnership other companies. Overall, we expect a 16% CAGR in volumes (led by growth in existing GAs and expansion into new GAs) and sustained high margins to drive a strong earnings CAGR of 26% over FY2021-FY2023E along with high RoE of 21.8% in FY2023E. Hence, we maintain a Buy rating on IGL with an unchanged PT of Rs. 650. At CMP, the stock is trading at 23.6x its FY2023E EPS and 21.3x its FY2024E 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 6.8-7 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 2030 (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	7.1
2	FMR LLC	3.1
3	Kotak Mahindra Asset Management Co	2.4
4	Vontobel Holding AG	2.4
5	VONTOBEL FUND	2.1
6	Vanguard Group Inc/The	1.8
7	BlackRock Inc	1.3
8	DSP Investment Managers Pvt. Ltd.	1.2
9	SBI Life Insurance Company Limited	1.1
10	Schroders PLC	1.0

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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