Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indraprastha Gas Ltd

Policy support to drive earnings recovery; valuation attractive

Oil & Gas	Sharekhan code: IGL

Reco/View: Buy	↔	CMP: **Rs. 418**	Price Target: **Rs. 480**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Jul 08, 2022				25.79
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

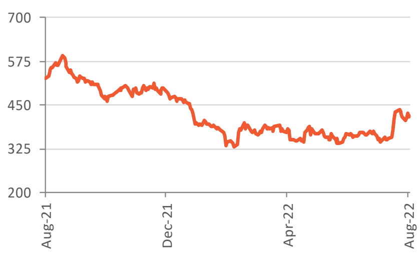
Company details

Market cap:	Rs. 29,292 cr
52-week high/low:	Rs. 604 / 322
NSE volume: (No of shares)	30.6 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	20.3
DII	16.8
Others	17.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	18.3	13.4	21.8	-20.3
Relative to Sensex	12.9	6.2	16.5	-25.1

Sharekhan Research, Bloomberg

Summary

- Recent favorable policy changes in the form of higher domestic gas allocation to CNG/D-PNG would help IGL to maintain its pricing power (likely CNG price cut would improve economics versus petrol) and monopoly in the exiting GA of NCR region.
- Higher APM gas allocation of 94% (versus 85% in Q1FY23) to CNG/D-PNG is expected to reduce gas cost by 25% to $8.4/mmBtu for IGL and provides room for further improvement in EBITDA margin in Q2FY23. A likely capping of domestic gas prices at current levels and use of term LNG could remove margin overhang and drive re-rating for CGD companies.
- Growth in existing GAs (of NCR region), ramp-up of new GAs of Rewari, Karnal and Gurugram and three GAs (won under the Xth CGD bidding round) would drive 14% volume CAGR over FY22-24E. We highlight here that IGL's CNG volume grew strongly by 21% in Q1FY23 as compared to peak pre-pandemic volume in Q3FY20.
- We maintain a Buy on IGL with an increased PT of Rs. 480 as we assign higher PE multiple given accommodative policy framework would improve volume/earnings growth visibility. IGL trades at an attractive valuation of 18.6x FY24E EPS, which is at 22% discount to 5-year average PE multiple of 24x.

The recent government decision to increase gas allocation for CNG and domestic PNG points to a favourable policy framework for CGDs as the space would be key to achieve government's target of 15% share of natural gas in India's energy mix by 2030 versus only 6% currently. Higher domestic gas allocation of 94% to CGDs is a near-term relief for CGDs and raises hope of more policy measures like capping of domestic gas price at current level. Continued policy support for CGDs would help sustain high volume growth and sustain/improve current margin for IGL. We thus maintain our Buy rating on IGL with a revised PT of Rs. 480.

- **Accommodative policies and volume ramp-up at new GAs – to drive double digit volume growth:** The government's decision to increase domestic gas allocation to CNG/D-PNG would lower gas cost of CGDs and we expect IGL to reduce CNG price (in line with MGL – recently cut CNG price in Mumbai by Rs. 6/kg). A lower CNG price would widen gap with petrol price (running cost of CNG cars is 41% lower than petrol cars in Delhi). This would help continued traction in addition of CNG cars and drive volume growth in existing GA of NCR region. IGL's is also ramping up its new GAs of Rewari, Karnal and Gurugram. We thus expect IGL to sustain its double-digit volume growth and expect 14% CAGR in gas sales volume over FY22-24E. We highlight here that IGL's CNG volume grew strongly by 21% in Q1FY23 as compared to peak pre-pandemic volume seen in Q3FY2020.
- **Gas cost to reduce by 25% in Q2FY23 on higher allocation of low cost domestic gas – bodes well for near term margin:** Government has recently increased domestic gas supply for CNG and domestic PNG to 94% versus 85% in Q1FY23. The move is expected to reduce gas cost for CGDs (for priority sector CNG and D-PNG) by 25% to $8.4/mmBtu from $10.5/mmBtu in August 2022 and sustain/improve IGL'S EBITDA margins (improved q-o-q by 20% to Rs. 8.6/scm per scm in Q1FY23) in Q2FY23 given exposure to CNG/D-PNG.
- **Likely capping of domestic gas price – could remove margin overhang:** We expect more accommodative policy measures by the government like 1) Revision in domestic gas pricing formula given high volatility in international gas price (especially NBP) and 2) Capping of domestic gas price as break-even cost for upstream PSU is estimated at ~$3.5/mmBtu. A potential capping of domestic gas price at current level would remove margin overhang (of higher domestic gas price, up 3.4x y-o-y to $6.1/mmBtu and lower availability of APM gas as seen in last one year) and drive re-rating for CGDs.

Our Call

Valuation – Maintain Buy on IGL with a revised PT of Rs. 480: IGL's valuation of 20.5x/18.6x FY23E/FY24E EPS is attractive given volume growth visibility supported by robust demand in the existing NCR region and ramp-up of new geographical areas (GAs) of Rewari, Karnal, and Gurugram. A potential capping of domestic gas price at current level would be key re-rating trigger for CGDs as it would improve confidence on both double-digit volume growth and sustained strong margins. We maintain a Buy on IGL with an increased PT of Rs. 480 as we assign higher PE multiple given accommodative policy framework would improve volume/earnings growth visibility.

Key Risks

Lower-than-expected gas sales volume in case of slowdown and lower CNG conversions. Delay in development of new GAs, a sustained elevated spot LNG price and adverse regulatory changes could affect outlook and valuations.

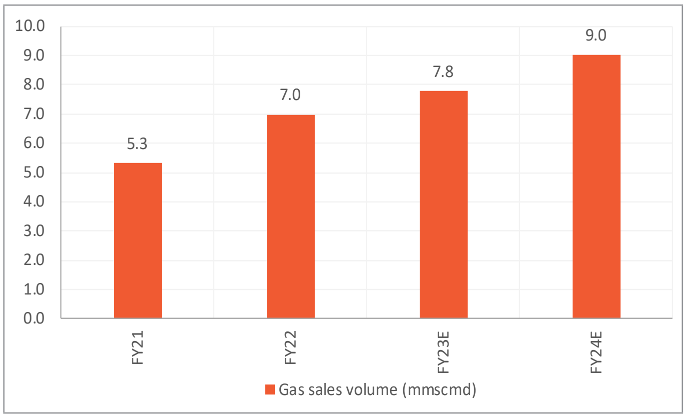
Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	4,941	7,710	9,523	11,311
OPM (%)	30.0	24.4	22.0	22.3
Adjusted PAT	1,006	1,315	1,429	1,573
% YoY growth	*-11.5*	*30.8*	*8.7*	*10.1*
Adjusted EPS (Rs.)	14.4	18.8	20.4	22.5
P/E (x)	29.1	22.3	20.5	18.6
P/B (x)	5.0	4.2	3.7	3.3
EV/EBITDA (x)	19.0	14.8	12.6	10.1
RoNW (%)	18.4	20.5	19.3	18.8
RoCE (%)	23.1	26.3	24.8	27.1

Source: Company; Sharekhan estimates

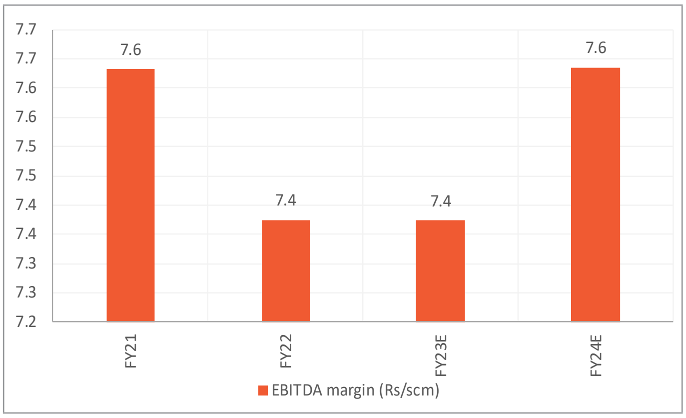
Financials in charts

Regulatory push to drive volume



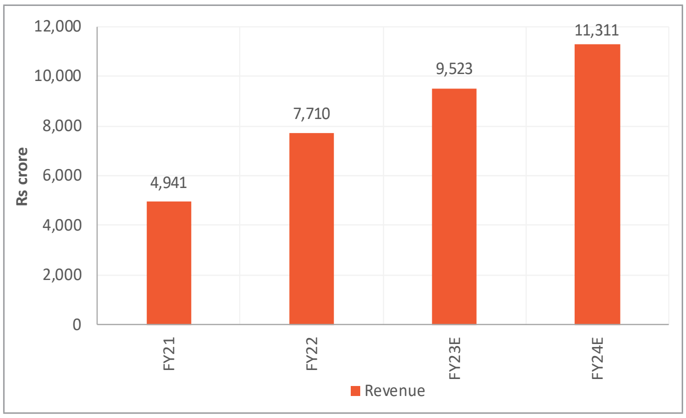
Source: Company, Sharekhan Research

Margin to remain range bound



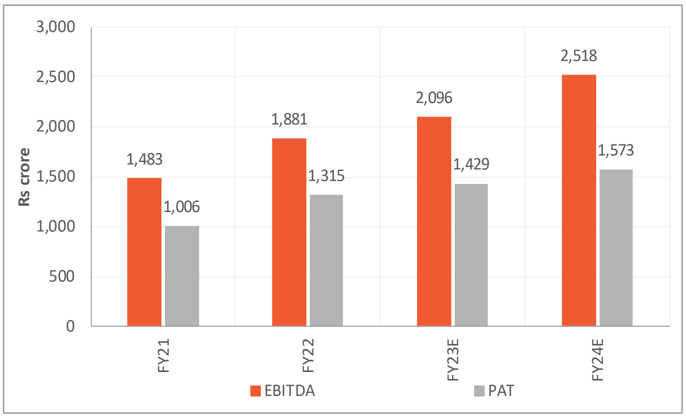
Source: Company, Sharekhan Research

Robust trend



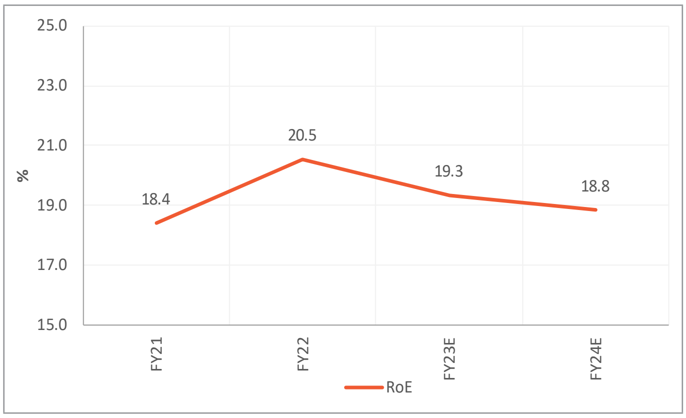
Source: Company, Sharekhan Research

EBITDA/PAT to report 16%9% CAGR over FY22-FY24E



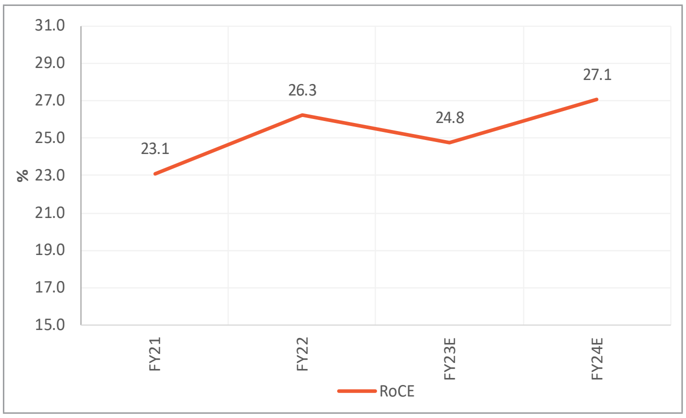
Source: Company, Sharekhan Research

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; supportive government policies could remove high gas cost overhang for CGDs

India's long-term gas demand potential is very strong, given regulatory support to curb pollution. . Additionally, the government's aim to increase the share of gas in India's overall energy mix to 15% by 2030 (from 6% currently) would substantially improve gas penetration and boost its consumption. Thus, we expect sustainable high single-digit growth in India gas demand for the next 4-5 years. However, high spot LNG prices, expectation of a further steep hike in APM gas price from October 2022 and indication of faster adoption of EVs is a cause of concern for CGDs. We highlight here that a potential capping of domestic gas price at current level could remove overhang of high cost and margin concern.

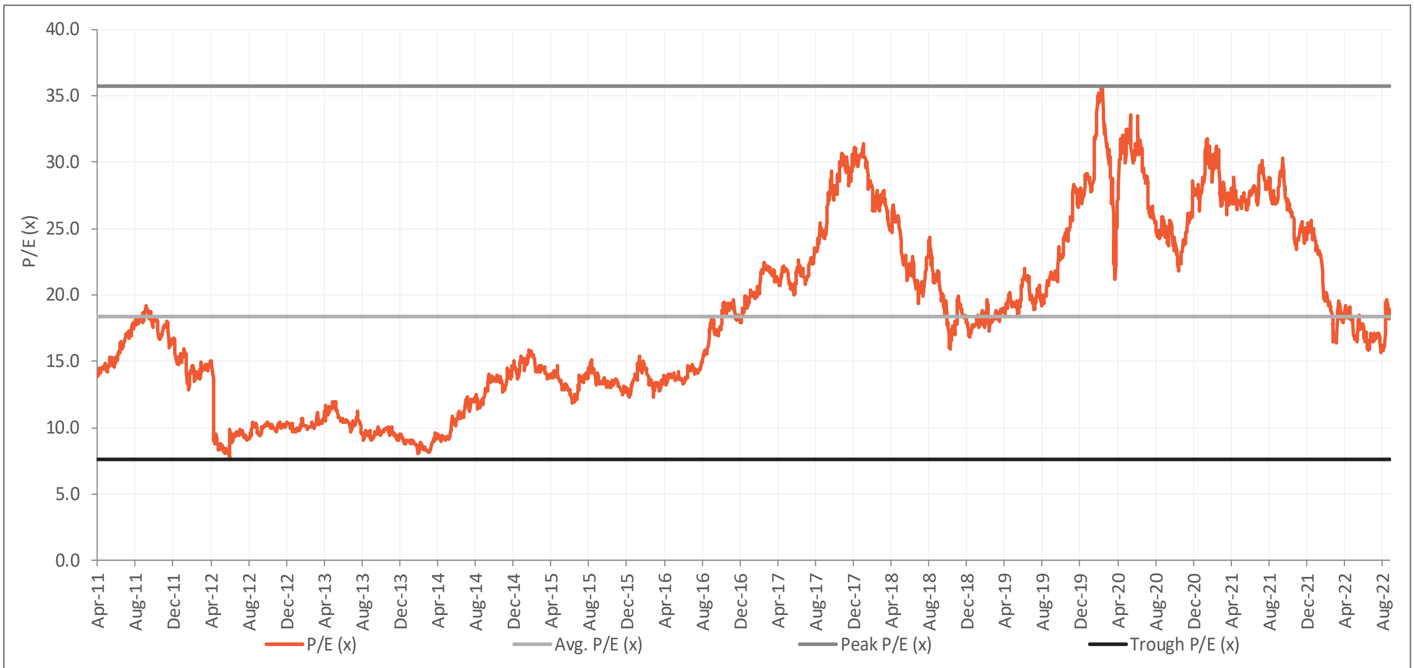
■ Company Outlook – Volume recovery on cards; margin to remain range bound

We believe that IGL is well-placed to benefit from rising gas consumption in India and thus we model 14% volume CAGR over FY2022-FY2024E led 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 in the Xth CGD bidding round). Continued mix of LNG, further hike in APM gas price and demand for high dealer commissions by OMCs is a concern for margins and thus we expect EBITDA margin to remain range bound at Rs. 7.4-7.6/scm over FY23E-24E. Hence, we expect a strong EBITDA/PAT CAGR of 16%/9% over FY2022-FY2024E. However, a likely capping of domestic gas price at current levels could improve margin and earnings outlook.

■ Valuation – Maintain Buy on IGL with a revised PT of Rs. 480

IGL's valuation of 20.5x/18.6x FY23E/FY24E EPS is attractive given volume growth visibility supported by robust demand in the existing NCR region and ramp-up of new geographical areas (GAs) of Rewari, Karnal, and Gurugram. A potential capping of domestic gas price at current level would be key re-rating trigger for CGDs as it would improve confidence on both double-digit volume growth and sustained strong margins. We maintain a Buy on IGL with an increased PT of Rs. 480 as we assign higher PE multiple given accommodative policy framework would improve volume/earnings growth visibility.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About company

IGL is a dominant CGD player in NCR (Delhi, Noida, Greater Noida, and Ghaziabad), with gas sales volume of over 7 mmscmd currently. IGL derives 73% 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 favourable economics of CNG versus petrol. Moreover, the recent sharp volume recovery above pre-COVID level re-enforces confidence with respect to volume led double-digit earnings growth outlook.

Key Risks

- Lower-than-expected gas sales volume in case of slowdown, lower CNG conversions 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.

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	7.5
2	FMR LLC	2.6
3	Kotak Mahindra Asset Management Co	2.1
4	Vanguard Group Inc/The	1.6
5	BlackRock Inc	1.5
6	Impax Asset Management Group Plc	1.4
7	HDFC Life Insurance Company Limited	1.2
8	BNP Paribas SA	1.2
9	DSP Equity Savings Fund	1.1
10	DSP Investment Managers Pvt. Ltd.	1.0

Source: Bloomberg (Old data)

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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