Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indraprastha Gas Ltd

Q2 misses mark; Likely APM gas price cut key for margin recovery

Oil & Gas		Sharekhan code: IGL		
Reco/View: Buy	↔	CMP: **Rs. 408**	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	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 25.79

Updated Oct 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 28,529 cr
52-week high/low:	Rs. 515/322
NSE volume: (No of shares)	25.9 lakh
BSE code:	532514
NSE code:	IGL
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	45.0
FII	21.0
DII	20.1
Others	13.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.0	15.8	6.8	-3.8
Relative to Sensex	-1.2	8.1	3.0	-10.9

Sharekhan Research, Bloomberg

Summary

- Q2FY2023 operating profit of Rs. 528 crore (down 15% q-o-q) missed our estimate of Rs. 629 crore due to sharply lower-than-expected EBITDA margin on high gas cost and no CNG price hike. Gas sales volume grew by 2.5% q-o-q to 8.1 mmcmd.
- EBITDA margin decline was much higher than expected at 18% q-o-q to Rs. 7.1/scm as gross margin was impacted due to no CNG price hike despite a 16% q-o-q increase in gas cost. CNG/D-PNG/I-C PNG volume was up by 2.7%/4.4%/2.2% q-o-q.
- Further CNG price hikes (post Rs. 3/kg hike recently) are key to sustain margin or IGL may see further margin decline in Q3FY2023. Having said that, a likely change in domestic gas price formula or capping of domestic gas price could help CGD retain pricing power in CNG and act as key rating catalyst. Management aims 10 mmscmd of volume in next two years, which implies 24% growth over Q2FY23 volume of 8.1 mmscmd.
- We maintain Buy on IGL with an unchanged PT of Rs. 480, as valuation of 18.3x its FY2024E EPS is attractive, given a steep discount of 23% to its five-year average one-year forward PE multiple of 24x.

Indraprastha Gas Limited's (IGL) Q2FY2023 results were below our expectations, with a 16% miss in standalone operating profit at Rs. 528 crore, down 0.5% y-o-y/14.6% q-o-q. The sharp miss in operating profit was primarily due to lower-than-expected EBITDA margin at Rs. 7.1/scm (down 17.6% q-o-q and versus estimate of Rs. 8.3/scm), while gas sales volumes witnessed 2.5% q-o-q growth to 8.1 mmscmd (marginally below our estimate of 8.2 mmscmd). The steep sequential decline in EBITDA margin was on account of high gas cost (up 16% q-o-q to Rs. 35.1/scm), while blended realisation increased by only 7% q-o-q to Rs. 47.8/scm as IGL did not take CNG price hike despite rise in gas cost. Higher cost impacted gross margin, which declined by 11% q-o-q to Rs. 12.7/scm (below our estimate of Rs. 13.4/scm). CNG sales volume was up 2.7% q-o-q to 6.1 mmscmd, while I-C PNG and D-PNG volume grew by 2.2%/4.4% q-o-q to 1 mmscmd/0.5 mmscmd. PAT of Rs. 416 crore (down 1.1% q-o-q) was 8% below our estimate due to miss in margin, partially offset by higher other income and lower tax rate of 23.4% (versus assumption of 25.2%).

Key positives

- CNG volume grew by 15% y-o-y/3% q-o-q to 6.1 mmscmd despite narrowing down of price gap between CNG-petrol.

Key negatives

- Sharply lower-than-expected gross/EBITDA margin at Rs. 12.7/Rs. 7.1 per scm, down 11%/17.6% q-o-q.

Revision in estimates – We have fine-tuned our FY2023-FY2024 earnings estimates to reflect marginal tweak in volume/margin assumption and have introduced our FY2025 earnings estimate in this report.

Our Call

Valuation – Maintain Buy on IGL with an unchanged PT of Rs. 480: IGL's valuation is attractive at 19.7x/18.3x/15.3x FY2023E/FY2024E/FY2025E EPS, 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 change in domestic gas price formula and likely capping of domestic gas price would be key re-rating triggers for CGDs, as it would improve confidence on both double-digit volume growth and sustained strong margins. We maintain Buy on IGL with an unchanged price target (PT) of Rs. 480.

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

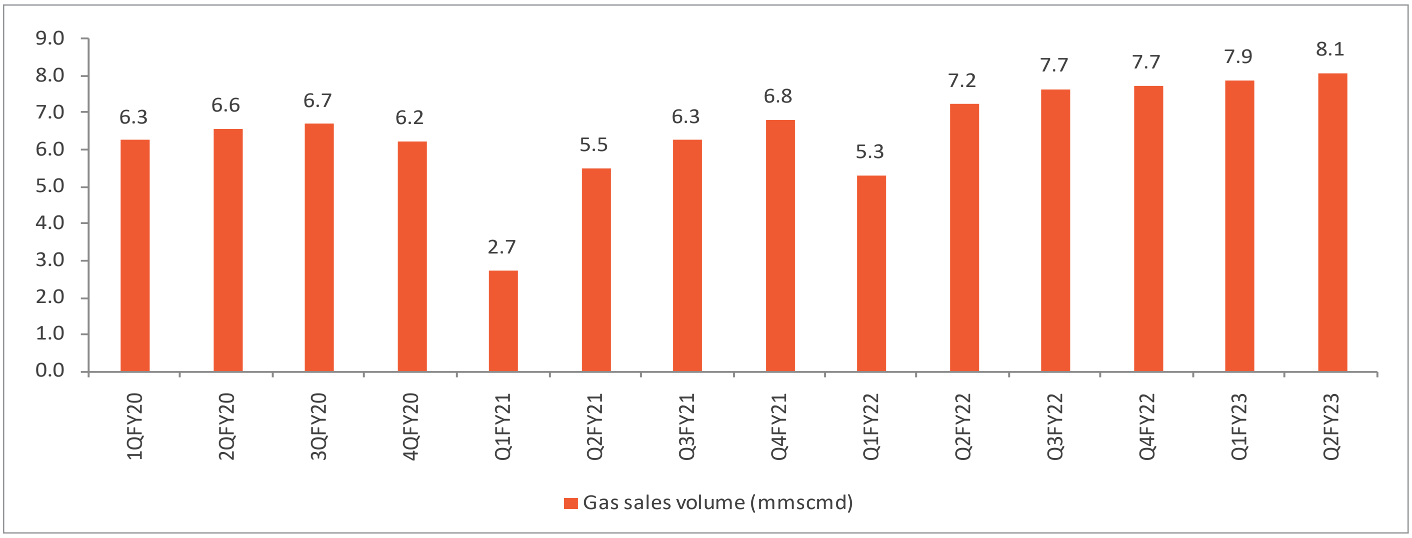
Particulars	FY22	FY23E	FY24E	FY25E
Revenue	7,710	12,377	11,925	12,999
OPM (%)	24.4	17.1	20.9	22.6
Adjusted PAT	1,315	1,447	1,557	1,861
% YoY growth	30.8	10.0	7.6	19.5
Adjusted EPS (Rs.)	18.8	20.7	22.2	26.6
P/E (x)	21.7	19.7	18.3	15.3
P/B (x)	4.1	3.6	3.2	2.8
EV/EBITDA (x)	14.4	11.6	9.5	7.5
RoNW (%)	20.5	19.6	18.6	19.7
RoCE (%)	26.3	25.1	26.8	28.3

Source: Company; Sharekhan estimates

Weak Q2 performance; Operating profit missed estimate on lower-than-expected margin

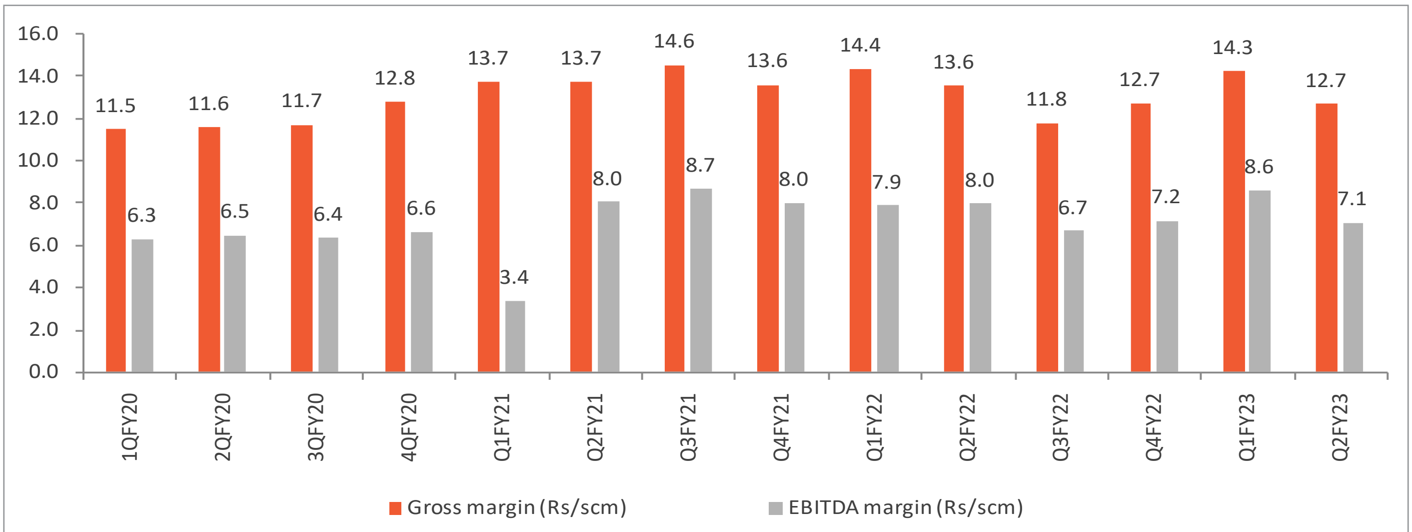
Q2FY2023 results were below our expectations, with a 16% miss in standalone operating profit at Rs. 528 crore, down 0.5% y-o-y/14.6% q-o-q. The sharp miss in operating profit was primarily due to lower-than-expected EBITDA margin at Rs. 7.1/scm (down 17.6% q-o-q versus estimate of Rs. 8.3/scm), while gas sales volumes witnessed 2.5% q-o-q growth to 8.1 mmscmd (marginally below our estimate of 8.2 mmscmd). The steep sequential decline in EBITDA margin was on account of high gas cost (up 16% q-o-q to Rs. 35.1/scm), while blended realisation increased by only 7% q-o-q to Rs. 47.8/scm, as IGL did not take CNG price hike despite rise in gas cost. Higher cost impacted gross margin, which declined by 11% q-o-q to Rs. 12.7/scm (below our estimate of Rs. 13.4/scm). CNG sales volume was up 2.7% q-o-q to 6.1 mmscmd, while I-C PNG and D-PNG volume grew by 2.2%/4.4% q-o-q to 1 mmscmd/0.5 mmscmd. PAT of Rs. 416 crore (down 1.1% q-o-q) was 8% below our estimate due to miss in margin partially offset by higher other income and lower tax rate of 23.4% (versus assumption of 25.2%).

Volume growth of 2.5% q-o-q in Q2FY2023



Source: Company, Sharekhan Research

Gross/EBITDA margin miss estimate in Q2FY23



Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**3,554**	**1,831**	**94.1**	**3,194**	**11.3**
Total Expenditure	3,026	1,301	132.6	2,576	17.5
Operating profit	**528**	**530**	**-0.5**	**618**	**-14.6**
Other Income	110	77	42.0	31	257.8
Interest	3	3	20.3	2	31.1
Depreciation	91	80	13.6	86	6.7
PBT	**543**	**525**	**3.5**	**560**	**-3.1**
Tax	127	124	2.3	139	-9.0
Reported PAT	**416**	**401**	**3.9**	**421**	**-1.1**
Equity Cap (cr)	70	70		70	
Reported EPS (Rs.)	5.9	5.7	3.9	6.0	-1.1
Margins (%)			**BPS**		**BPS**
OPM	14.8	29.0	-1411.0	19.3	-449.1
NPM	11.7	21.9	-1016.4	13.2	-146.8
Tax rate	23.4	23.6	-28.6	24.9	-151.6

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Total volume (mmscmd)	8.1	7.2	11.8	7.9	2.5
Gross margin (Rs./scm)	12.7	13.6	-6.4	14.3	-11.0
EBITDA margin (Rs./scm)	7.1	8.0	-11.0	8.6	-17.6
CNG volume (mmscmd)	6.1	5.3	14.9	5.9	2.7
PNG volume (mmscmd)	2.0	1.9	3.3	2.0	2.2

Source: Company, Sharekhan Research

Volume break-up by categories (figures in mmscmd)

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
CNG	6.1	5.3	15%	5.9	2.7%
PNG domestic	0.5	0.5	11%	0.5	4.4%
I/C PNG	1.0	1.0	1%	1.0	2.2%
Natural gas	0.5	0.5	0%	0.5	-0.1%
Total volume	**8.1**	**7.2**	**11.8%**	**7.9**	**2.5%**
Volume mix					
CNG	75	73	204	75	9
PNG domestic	6	6	-3	6	11
I/C PNG	12	14	-131	12	-4
Natural gas	6	7	-70	6	-16
Total	**100**	**100**		**100**	

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's 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 are causes of concern for CGDs. We highlight here that a potential capping of domestic gas price or change in domestic gas pricing formula could remove the overhang of high-cost and margin concern.

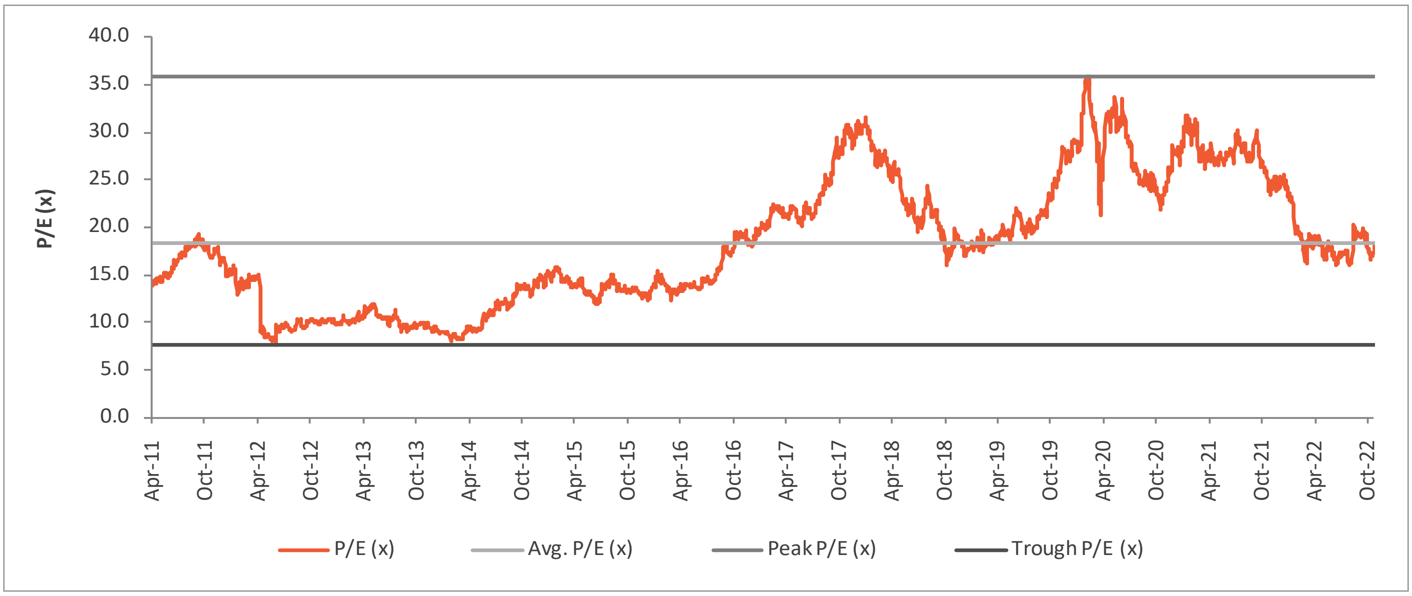
■ Company outlook - Volume recovery on cards; Margin to remain range bound

We believe IGL is well placed to benefit from rising gas consumption in India. Thus, we model a 12% volume CAGR over FY2022-FY2022E, 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 and recent steep hike in APM gas price are key margin concerns; and thus, we expect EBITDA margin to remain range bound at Rs. 7.4-7.6/scm over FY2023E-FY2024E before a likely improvement to Rs. 8.2/scm in FY2025E. Hence, we expect a strong EBITDA/PAT CAGR of 16%/12% over FY2022-FY2025E. However, a likely capping of domestic gas price or revision in the domestic as pricing formula could improve margin and earnings outlook.

■ Valuation - Maintain Buy on IGL with an unchanged PT of Rs. 480

IGL's valuation is attractive at 19.8x/18.4x/15.4x FY2023E/FY2024E/FY2025E EPS, 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 change in domestic gas price formula and likely capping of domestic gas price would be key re-rating triggers for CGDs, as it would improve confidence on both double-digit volume growth and sustained strong margins. We maintain Buy on IGL with an unchanged PT of Rs. 480.

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 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. A potential revision in domestic gas pricing formula or capping of APM gas price could bring back pricing power in the CNG segment and aid margin recovery for CGDs. The sharp stock price correction from 52-week high makes valuation of IGL attractive, as we expect the government's policy support to drive recovery in earnings.

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

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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