Prabhudas Lilladher

Company Report
Industry: Oil & Gas

Indraprastha Gas

Play on Delhi's pollution concern

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Contents

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Indraprastha Gas

Company Report
December 16, 2015

Rating	**BUY**
Price	Rs500
Target Price	Rs576
Implied Upside	15.2%
Sensex	25,494
Nifty	7,751

(Prices as on December 16, 2015)

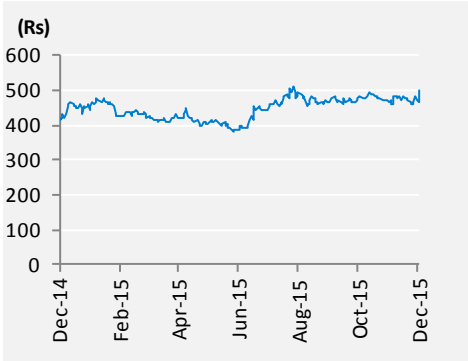
Trading data	
Market Cap. (Rs m)	70,000.0
Shares o/s (m)	140.0
3M Avg. Daily value (Rs m)	165.6

Major shareholders	
Promoters	45.00%
Foreign	18.51%
Domestic Inst.	22.76%
Public & Other	13.73%

Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	6.9	29.8	20.7
Relative	7.9	34.3	25.5

How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2016	36.1	36.1	*0.1*
2017	39.7	40.0	*-0.9*

Price Performance (RIC: IGAS.BO, BB: IGL IN)



Source: Bloomberg

- **Attractive play on gas marketing:** IGL is a monopoly gas distribution company in the National Capital Region (NCR). Supported by gas demand revival of 4.5% CAGR over FY15-17E, after a sedate FY15, we expect earnings growth of 12.6% CAGR. Meanwhile, secured gas supply for CNG and for domestic PNG coupled with favourable gas economics (19-56% cheaper to petrol and diesel) will spur growth beyond regulated consumption in the medium term as gas outscores competing fuels linked to crude. Also, post the peak capex phase (sustainable capex of Rs 2bn against F11-15 average of Rs4.3bn), we expect IGL's FCF yield to rise to ~6% in FY17E.

- **Pollution concerns in Delhi to help spur volumes:** IGL's gas sales momentum is set to pick-up as rising pollution concerns in Delhi spurs demand for Compressed Natural Gas (CNG). We expect demand growth of 4.8% CAGR over FY15-17E led by **1)** new bus additions as NCR **2)** conversion of ~50,000 app-based taxi operators and **3)** discretionary conversion by private cars. Meanwhile, Piped Natural Gas (PNG) volumes are likely to ride on domestic customer addition and revival in industrial and commercial demand; reported resolution of the Rasgas contract impasse provides upside risk to commercial PNG volumes.

- **Branching out:** IGL plans to expand its geographical footprint and has taken 50% stake in CGD players like Maharashtra Natural Gas (MNGL) and Central UP Gas (CUGL). While MNGL caters to Pune markets and its neighbouring areas, CUGL caters to Kanpur and Bareilly in UP. MNGL and CUGL have reported impressive growth supported by EBIDTA/scm spreads of Rs8.5/scm and Rs 7.0/scm.

- **Initiate with 'BUY' and PT of Rs576:** We initiate with a 'BUY' on the stock with a PT of Rs576, based on DCF of core business (Rs558/sh) and add the value of its investments in MNGL and CUGL at book value (Rs18/sh).

Key financials (Y/e March)	2014	2015	2016E	2017E
Revenues (Rs m)	39,222	36,810	38,281	39,747
Growth (%)	*16.5*	*(6.1)*	*4.0*	*3.8*
EBITDA (Rs m)	7,824	7,930	8,887	9,412
PAT (Rs m)	3,603	4,377	5,060	5,554
EPS (Rs)	25.7	31.3	36.1	39.7
Growth (%)	*1.7*	*21.5*	*15.6*	*9.8*
Net DPS (Rs)	6.4	7.0	8.5	9.3

Profitability & Valuation	2014	2015	2016E	2017E
EBITDA margin (%)	*19.9*	*21.5*	*23.2*	*23.7*
RoE (%)	*22.1*	*22.7*	*22.1*	*20.6*
RoCE (%)	*19.9*	*21.2*	*21.3*	*20.1*
EV / sales (x)	1.8	1.9	1.7	1.5
EV / EBITDA (x)	9.0	8.7	7.3	6.5
PE (x)	19.4	16.0	13.8	12.6
P / BV (x)	4.0	3.3	2.8	2.4
Net dividend yield (%)	*1.3*	*1.4*	*1.7*	*1.9*

Source: Company Data; PL Research

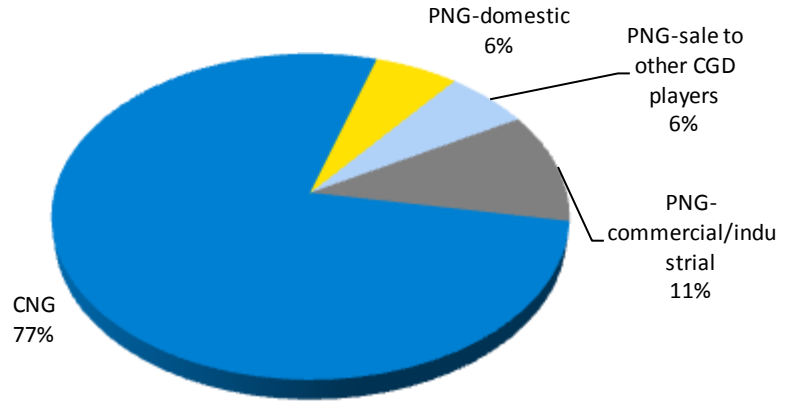
Volume traction + healthy spreads = profit growth

Increased pollution concerns to aid CNG volume growth

Worsening pollution in Delhi has brought spotlight on CNG as judicial activism prompts severe clampdown on polluting diesel vehicles. Recently, the Hon, Supreme Court has suggested to **1)** banning registration of diesel cars above 2000cc from 1st January to 31st March 2016 **2)** banning of commercial vehicles over 10 years entry in Delhi and **3)** conversion of all taxis to CNG by 31st March 2016. IGL is a clear beneficiary of this development. Accordingly, IGL's volume trajectory is set to pick up over FY15-17E after a sluggish FY15, in our view. We expect CNG sales (77% of FY15 sales volumes) to increase at 4.8% CAGR over FY15-17E (~3% over FY13-15) and is expected to ride on the following growth initiatives:

- New buses likely to be added after three years as the Delhi government plans to add over 500 buses in the public transport system.
- Expansion of private bus cluster in public transport system is likely to expand in a major way as they add 50-60 buses per month.
- Conversion of web-based taxi services to CNG is an impressive opportunity for IGL in the near term. Total app based taxi population stands at ~50,000, which the Delhi High court has mandated for conversion to CNG by 1st March 2016.
- Reports of marketing freedom to set up CNG stations across the highways is a big opportunity for the City gas players as it will help improve the discretionary demand pick up.
- Discretionary conversion of private vehicles, given favourable economics as CNG is cheaper to petrol and diesel by 19% and 56% respectively.

Exhibit 1: IGL's segment-wise sales



Source: Company Data, PL Research

PNG sales also likely to recover after a disappointing FY15

Even as CNG volumes maintain their momentum, PNG (Piped Natural Gas) volumes were hurt due to low offtake from industrial and commercial units (11% of FY15 volume). High LNG prices (IGL has contracted for Rasgas volumes) also accelerated the fall as demand shifted to cheaper liquid fuels like fuel oil and diesel. Meanwhile reports of resolution to the Rasgas contract augurs well for IGL's as the gas prices will come off to US$8/mmbtu against current price of US$12.5/mmbtu; thereby supporting demand recovery of commercial and industrial gas.

IGL is also aggressively pushing for PNG domestic volumes in Delhi and NCR as the government plans to reduce the subsidy outgo. For FY15, IGL added over 0.1m PNG domestic consumers. Favourable economics and ease of usage is a massive plus which drives PNG volumes. PNG domestic scores over subsidised LPG and is cheaper by 12% and the economics improve as the share of higher priced non-subsidised LPG moves up.

Exhibit 2: PNG domestic economics vis-a-vis LPG

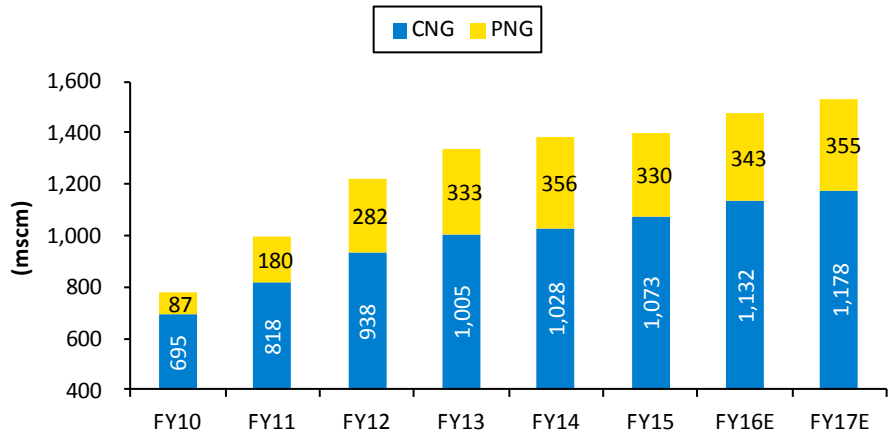
Subsidized cylinders provided	No	12	9	6	0
Annual consumption of Cylinders	No	12	12	12	12
Subsidized rate	Rs/Cylinder	419.8	419.8	419.8	419.8
Non - subsidized rate Rs/Cylinder	Rs/Cylinder	606.5	606.5	606.5	606.5
Annual cost	Rs	5,424	5,598	6,158	7,278
Annual requirement of LPG KGs	Kgs	170.4	170.4	170.4	170.4
Cost per kg	Rs	31.8	32.9	36.1	42.7
GCV Unit	Kcal/Kg	10,800	10,800	10,800	10,800
Energy Cost for LPG cylinders	**Rs/million Kcal**	**2,947**	**3,042**	**3,346**	**3,955**
PNG rate (including taxes)	Rs/m3	24.65	24.65	24.65	24.65
GCV of PNG	Kcal/m3	9,500	9,500	9,500	9,500
Energy Cost for PNG-domestic	**Rs/million Kcal**	**2,595**	**2,595**	**2,595**	**2,595**
Difference		-12%	-15%	-22%	-34%

Source: PL Research, Industry

Accordingly, supported by improved domestic sales, we expect PNG volumes to accelerate to 3.6% CAGR over FY15-17E.

Buoyed by demand revival in PNG and continued uptick in CNG, we expect IGL's volumes to grow at 4.5% CAGR over FY15-17E.

Exhibit 3: IGL's sales volume likely to register 4.8% CAGR over FY15-17E



Source: Company Data, PL Research

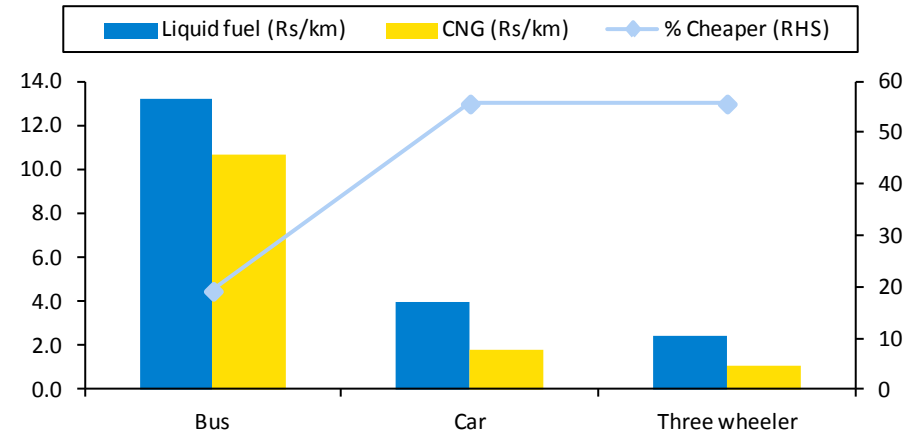
Fuel economics a key variable for discretionary demand

CNG remains 19% and 56% cheaper to diesel and petrol, respectively

CNG remains the most affordable fuel for transportation in the NCR region. At the current prices, CNG remains 19% cheaper to diesel and 56% cheaper to petrol in Delhi. Even as the international crude and product prices have crashed by 50% over last one year, domestic fuel price changes has been much less (10% diesel price cut since March 2015).

Government's decision to impose excise duties on petrol and diesel has pushed up retail prices of liquid fuel. Accordingly, we expect CNG fuel economics to remain favourable in the medium term, which in turn, will continue to drive discretionary demand.

Exhibit 4: CNG fuel economics

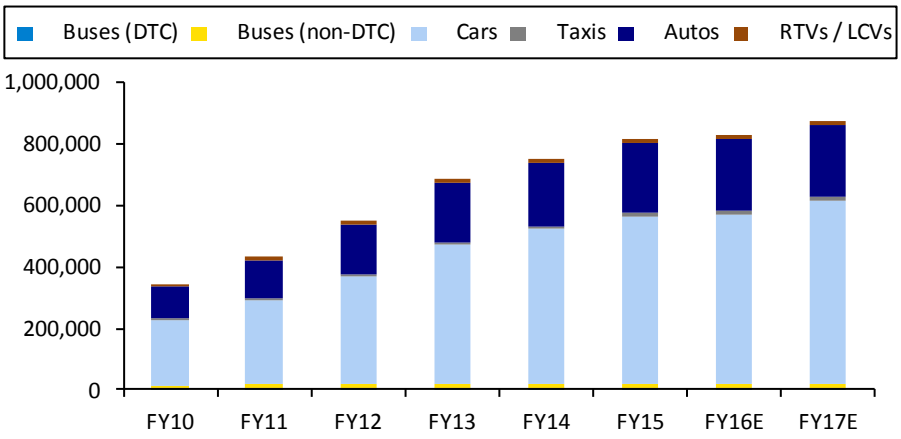


Source: PL Research

CNG vehicle population growth at 19% CAGR over FY10-15

Favourable fuel economics has led to 19% CAGR volume growth over FY10-15. Besides public transport, private vehicle population has increased at 21% CAGR, primarily due to discretionary vehicle conversion demand. With government expectation to introduce new buses and autos, coupled with discretionary private vehicle conversion, we expect CNG vehicle population to grow to 0.88m by FY17E.

Exhibit 5: CNG vehicle population growth



Source: Company Data, PL Research

Big growth opportunity in highway CNG marketing

The lack of distribution infrastructure and limited availability through dispensing centres has prevented the plying of CNG on highways. The Government has been contemplating expansion of CNG filling stations network in the country along 12,500 kilometres of National and State highways that are in the vicinity of existing and proposed gas pipelines.

CNG filling stations can be established on highways covering approximately 6,500 kilometres and in 42 cities in close proximity of already existing pipelines. Further, CNG filling stations en-route 6,000 kilometres of highway and in 58 cities can be synchronised with the implementation of planned pipelines. The creation of a CNG corridor is aimed at developing user confidence in CNG's availability and would prompt a switch to CNG for passenger and commercial vehicles. Delhi which connects different locations like Jaipur, Agra, and Chandigarh offers exciting growth opportunities for IGL. We have not factored in any capex or growth opportunities pending clarity from the regulator.

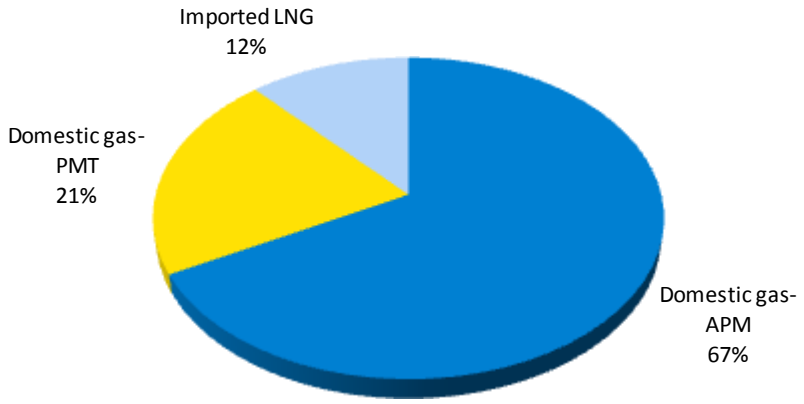
Spreads to stay healthy in the medium term

Cheaper domestic gas to support margins

Government's decision to provide 100% domestic gas for CNG and PNG for domestic customers is a major initiative as it removes the City Gas Distributors from the vagaries of fluctuating imported LNG market. With the domestic gas linked to international benchmark prices of US, UK, Russia and Canada, domestic prices were reset at US$4.2/mmbtu for H2FY16, effective October 2015 (US$5.2/mmbtu in H1FY16).

Meanwhile, domestic gas prices are likely to remain benign, given multiple LNG supplies coming on stream along with strong US shale volumes even as we have factored in domestic supplies at US$4.7/4.5/mmbtu for FY16/17E.

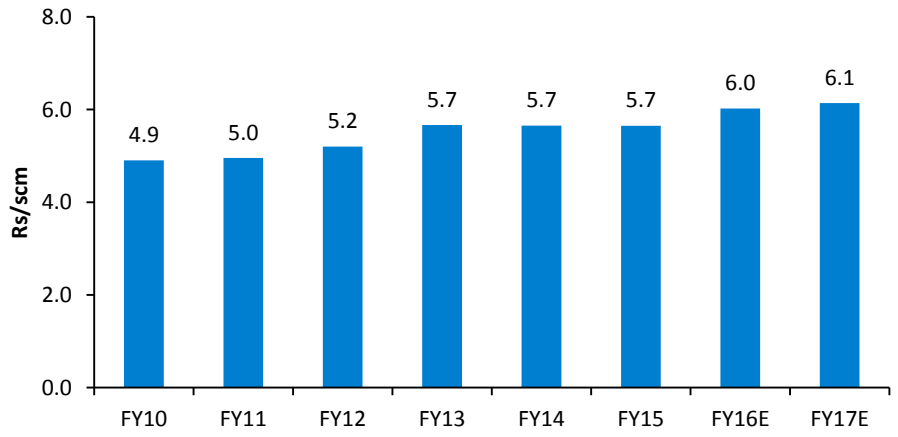
Exhibit 6: IGL gas sourcing



Source: Company Data, PL Research

IGL's management has consistently focussed on maintaining margins as reflected in spreads being consistently over Rs5.2/scm since FY12. Supported by cheaper gas, we expect spreads to maintain even as the company has cut retail prices by Rs0.8/kg effective October *2015.W*e expect IGL's margins to sustain at Rs6.0/6.1/scm for FY16/17E.

Exhibit 7: IGL's spreads continue to remain healthy



Source: Company Data, PL Research

Geographical expansion is on fast track

Value accretive acquisitions will help expand footprint

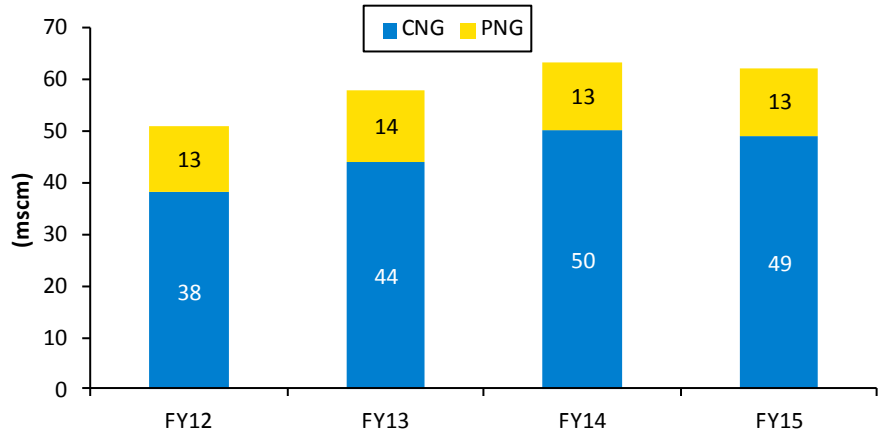
IGL has recently acquired 50% stake in CUGL and (MNGL to help expand their footprint beyond the NCR region. Both the entities are highly profitable in their respective sphere of activity.

CUGL

CUGL is engaged in City Gas Distribution in the cities of Kanpur and Bareilly in Uttar Pradesh. The company has a network of 14 CNG stations in Kanpur and two CNG stations in Bareilly. As of FY15, CUGL was catering to 46,610 CNG vehicles. Besides that, there were 8345 domestic, 119 commercial and 39 industrial customers as on FY15 end.

CUGL's total gas sales volumes have increased at a sluggish pace of ~7% CAGR over FY12-15 to 62.2mscm. Meanwhile, CNG sales growth was at ~9% CAGR to 49.1mscm during FY12-15, while PNG volumes growth was muted at ~3% CAGR over the same period.

Exhibit 8: CUGL's volume growth is sluggish

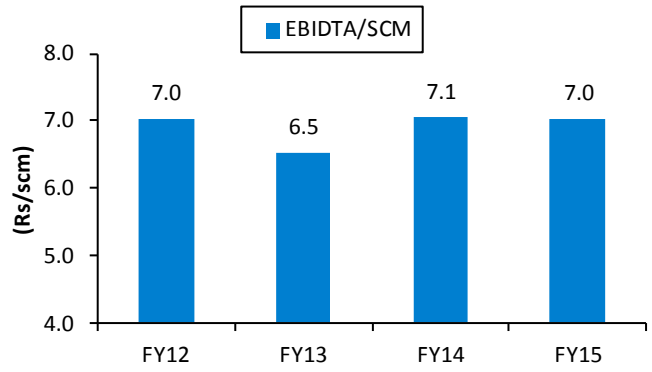


Source: Company Data, PL Research

Profitable growth

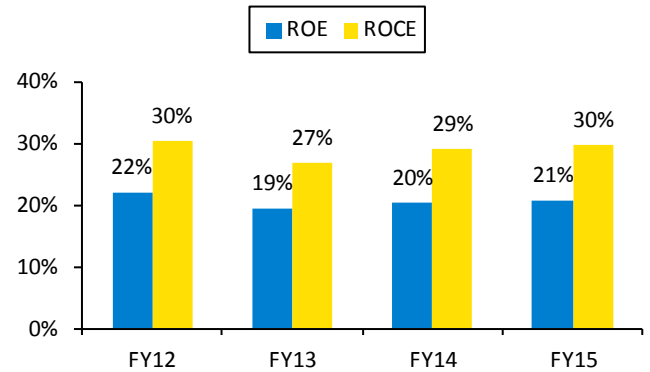
CUGL has maintained a healthy profitability trend with EBITDA/scm of ~Rs7 despite sluggish volume growth, a function of differential tax rates on CNG and liquid fuels. Backed by strong focus on profitability, CUGL's PAT increased to Rs275m in FY15 (CAGR of 9% over FY12-15). Also, the ROE and ROCE profile were maintained at ~20% and 29%, respectively.

Exhibit 9: EBITDA spreads remain healthy



Source: Company Data, PL Research

Exhibit 10: Return ratios maintained at elevated levels



Source: Company Data, PL Research

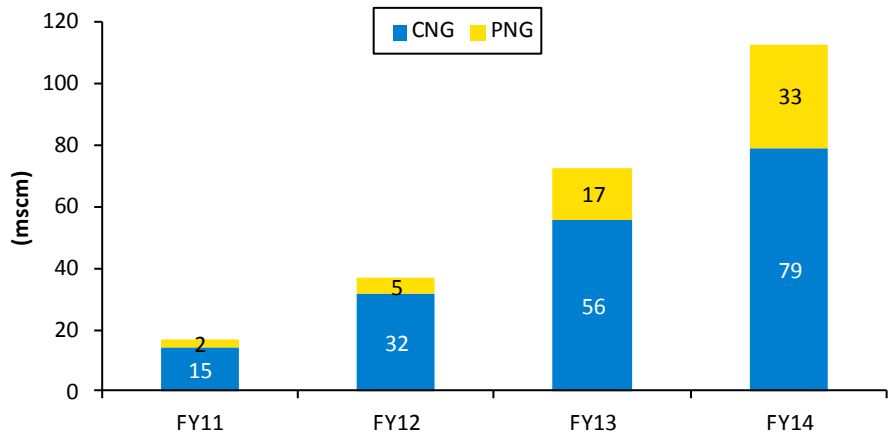
Maharashtra Natural Gas (MNGL)

MNGL is engaged in City Gas Distribution of Pune & Pimpri-Chinchwad city including adjoining areas of Hinjewadi, Chakan & Talegaon. The company plans to subsequently move on to other districts of Maharashtra depending on economic feasibility.

The company has a network of 28 CNG stations in their network. As of FY14, MNGL was catering to 60,279 CNG vehicles. Besides that there were 12,324 domestic, 31 commercial and 83 industrial customers as on FY14 end.

MNGL's total gas sales volumes have increased at an impressive pace of ~88% CAGR over FY11-14 to 112.4mscm, albeit over a low base. While the CNG sales growth was at ~76% CAGR to 79mscm during FY11-14, while PNG volumes growth was strong at 138% CAGR over the same period.

Exhibit 11: MNGL's volume momentum remains strong

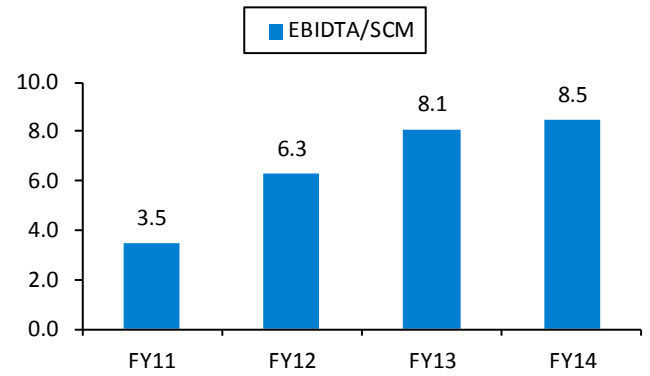


Source: Company Data, PL Research

Profitable growth

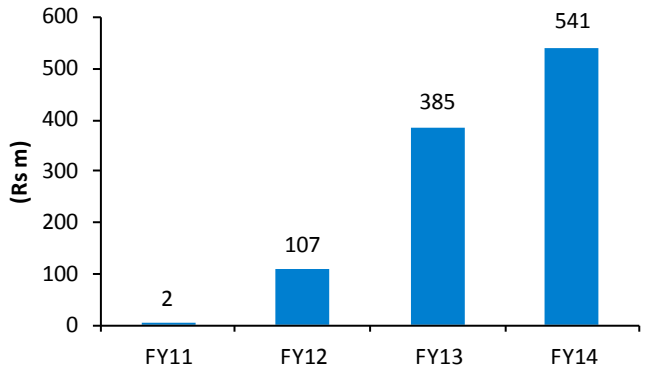
MNGL has maintained a healthy profitability trend with EBITDA/scm of Rs8.5 for FY14, among the highest in the sector. Backed by strong focus on profitability, MNGL's PAT increased to Rs541m in FY14 (CAGR of 552% over FY11-14). Accordingly, the ROE and ROCE has improved to ~32% and 31%, respectively.

Exhibit 12: EBITDA spreads remain healthy



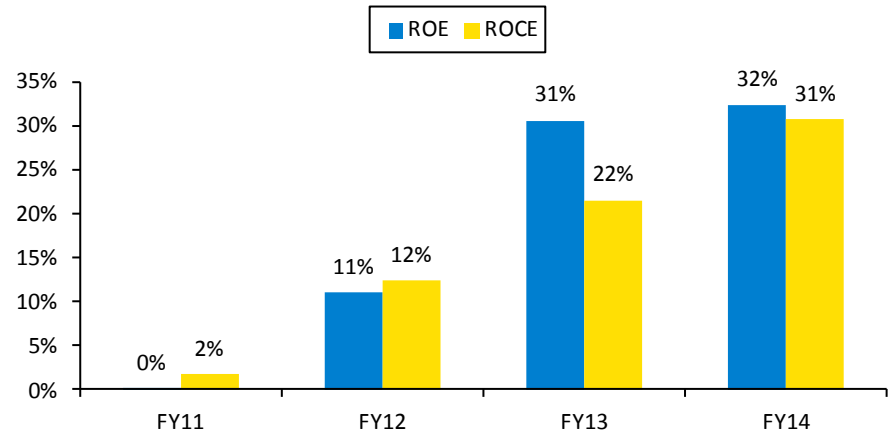
Source: Company Data, PL Research

Exhibit 13: Profits have zoomed with volumes



Source: Company Data, PL Research

Exhibit 14: ROE/ROCE has improved in line with profitability

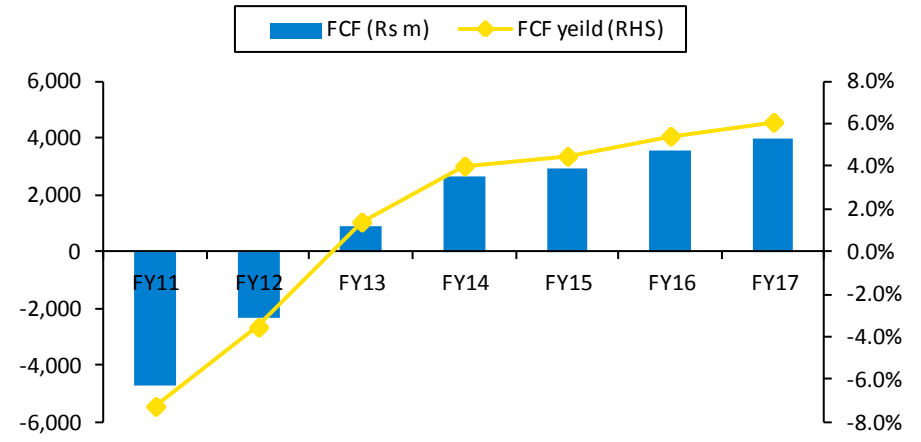


Source: Company Data, PL Research

Financial analysis

FCF yield to rise to ~6% in FY17E: IGL has passed the peak capex phase, which means FCF yield is expected to rise to ~6%. The company expects sustainable capex of ~Rs2bn p.a, against F11-15 average of Rs4.3bn.

Exhibit 15: IGL FCF yield to move up as company passes peak capex phase



Source: Company Data, PL Research

We expect IGL's standalone earnings to grow at 12.6% CAGR over FY15-17E. Key drivers for the growth are as follows:

- Volume growth recovery to 4.5% CAGR over FY15-17E post a sluggish FY15 volume growth of 1.4%.
- We expect CNG volume growth to accelerate to 4.8% CAGR over FY15-17E, while PNG volumes are to recover to CAGR of 3.6%.
- Healthy spreads at Rs6.1/scm over FY16/17E due to recent fall in gas prices even as retail prices are unchanged; FY15 EBITDA/scm at 5.7.

Exhibit 16: Key assumptions

	FY13	FY14	FY15	FY16E	FY17E
CNG volumes (mscm)	1,005	1,028	1,073	1,132	1,178
PNG volumes (mscm)	333	356	330	343	355
EBIDTA/scm	5.7	5.7	5.7	6.0	6.1

Source: Company Data, PL Research

Valuations

We believe that DCF valuation best captures the inherent value of IGL (estimated at Rs558/share) due to the utility nature of its earnings. Our DCF factors in the following assumptions:

- EBITDA is as per explicit forecast till FY17. For FY17-20, we have factored in EBITDA growth of 4%.
- We have maintained capex at Rs2bn over FY16-20E.
- WACC is assumed at 10% with terminal growth of 2%.

Exhibit 17: IGL DCF

	FY2014	FY2015	FY2016E	FY2017E	FY2018E	FY2019E	FY2020E
EBITDA (Rs mn)	7,824	7,930	8,887	9,412	9,944	10,253	10,593
Depreciation (Rs mn)	2,195	1,487	1,598	1,708	1,804	1,901	1,998
EBIT (Rs mn)	5,628	6,443	7,290	7,704	8,140	8,352	8,595
Current tax on EBIT (Rs mn)	-1,676	-1,795	-2,114	-2,321	-2,545	-2,719	-2,906
Depreciation (Rs mn)	2,195	1,487	1,598	1,708	1,804	1,901	1,998
Total capex (Rs mn)	-2,257	-1,946	-2,000	-2,000	-2,000	-2,000	-2,000
Chg. in net working capital (Rs mn)	-601	159	98	98	136	114	116
Total free cash flows (Rs mn)	3,289	4,348	4,871	5,188	5,535	5,648	5,803
WACC	10.0%						
Terminal growth rate	2.0%						
Terminal value	72,790						
Enterprise value	66,887						
Net debt as on Mar 17	(11,184)						
Equity value	78,071						
Value per share	**558**						

Source: PL Research

We also add the value of IGL's investments in CUGL and MNGL of Rs2.5bn at book value.

Exhibit 18: IGL valuation matrix

	Rs m	Rs/sh
Core value	78,476	558
Add: Strategic investments-		
-CUGL	692	5
-MNGL	1805	13
Total	**80,973**	**576**

Source: PL Research

Sensitivity and risks

- **Exchange rate**: IGL's gas supplies are priced in USD even as the retail prices are priced in INR. Accordingly, the company is exposed to US/INR volatility. Every USD/INR 1 change without corresponding change in retail prices, impacts earnings by 4%.

- **Retail price change**: IGL's earnings are highly susceptible to retail prices. Accordingly, every Rs1 change in CNG retail prices impact earnings by 9.6%.

Exhibit 19: IGL earnings sensitivity

Base case	Sensitivity	FY16E EPS	% change
FY16E US$/Rs at 65.1	US$/Rs at 66.1	35.4	-4%
CNG FY16 price of Rs 37.3	CNG price at Rs 36.3	33.3	-10%

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2014	2015	2016E	2017E
Net Revenue	**39,222**	**36,810**	**38,281**	**39,747**
Raw Material Expenses	26,813	23,408	22,219	22,259
Gross Profit	12,409	13,402	16,063	17,487
Employee Cost	596	660	792	911
Other Expenses	3,990	4,811	6,383	7,165
EBITDA	**7,824**	**7,930**	**8,887**	**9,412**
Depr. & Amortization	2,195	1,487	1,598	1,708
Net Interest	441	298	162	138
Other Income	211	345	424	724
Profit before Tax	**5,398**	**6,490**	**7,552**	**8,290**
Total Tax	1,795	2,113	2,492	2,736
Profit after Tax	**3,603**	**4,377**	**5,060**	**5,554**
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	**3,603**	**4,377**	**5,060**	**5,554**
Avg. Shares O/S (m)	**140.0**	**140.0**	**140.0**	**140.0**
EPS (Rs.)	**25.7**	**31.3**	**36.1**	**39.7**

Balance Sheet Abstract (Rs m)

Y/e March	2014	2015	2016E	2017E
Shareholder's Funds	17,631	20,981	24,858	29,114
Total Debt	3,212	1,453	1,253	1,053
Other Liabilities	963	1,272	1,649	2,064
Total Liabilities	**21,806**	**23,706**	**27,760**	**32,231**
Net Fixed Assets	21,576	22,099	22,501	22,794
Goodwill	—	—	—	—
Investments	1,174	2,909	2,909	2,909
Net Current Assets	(942)	(1,300)	2,350	6,529
Cash & Equivalents	*2,514*	*2,315*	*6,063*	*10,340*
Other Current Assets	*3,257*	*3,414*	*3,550*	*3,686*
Current Liabilities	*6,713*	*7,029*	*7,263*	*7,497*
Other Assets	—	—	—	—
Total Assets	**21,807**	**23,707**	**27,760**	**32,231**

Cash Flow Abstract (Rs m)

Y/e March	2014	2015	2016E	2017E
C/F from Operations	5,638	6,322	6,918	7,498
C/F from Investing	(2,133)	(3,746)	(2,000)	(2,000)
C/F from Financing	(1,502)	(2,776)	(1,168)	(1,222)
Inc. / Dec. in Cash	2,004	(200)	3,750	4,276
Opening Cash	—	—	—	—
Closing Cash	—	—	—	—
FCFF	2,650	3,995	4,214	5,359
FCFE	2,371	2,236	4,014	5,159

Quarterly Financials (Rs m)

Y/e March	Q3FY15	Q4FY15	Q1FY16	Q2FY16
Net Revenue	**9,444**	**9,168**	**9,018**	**9,692**
EBITDA	**1,920**	**1,758**	**1,961**	**1,914**
% of revenue	*20.3*	*19.2*	*21.7*	*19.7*
Depr. & Amortization	376	374	386	395
Net Interest	63	40	36	27
Other Income	114	68	56	66
Profit before Tax	**1,595**	**1,413**	**1,596**	**1,557**
Total Tax	513	454	577	542
Profit after Tax	**1,082**	**959**	**1,018**	**1,016**
Adj. PAT	**1,082**	**959**	**1,018**	**1,016**

Key Financial Metrics

Y/e March	2014	2015	2016E	2017E
Growth				
Revenue (%)	16.5	(6.1)	4.0	3.8
EBITDA (%)	3.2	1.4	12.1	5.9
PAT (%)	1.7	21.5	15.6	9.8
EPS (%)	1.7	21.5	15.6	9.8
Profitability				
EBITDA Margin (%)	19.9	21.5	23.2	23.7
PAT Margin (%)	9.2	11.9	13.2	14.0
RoCE (%)	19.9	21.2	21.3	20.1
RoE (%)	22.1	22.7	22.1	20.6
Balance Sheet				
Net Debt : Equity	—	—	(0.2)	(0.3)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	19.4	16.0	13.8	12.6
P / B (x)	4.0	3.3	2.8	2.4
EV / EBITDA (x)	9.0	8.7	7.3	6.5
EV / Sales (x)	1.8	1.9	1.7	1.5
Earnings Quality				
Eff. Tax Rate	33.3	32.6	33.0	33.0
Other Inc / PBT	3.9	5.3	5.6	8.7
Eff. Depr. Rate (%)	7.4	4.7	4.7	4.7
FCFE / PAT	65.8	51.1	79.3	92.9

Source: Company Data, PL Research.

Key Operating Metrics

Y/e March	2014	2015	2016E	2017E
Total sales volumes (mscm)	1,384.0	1,403.6	1,475.9	1,532.6
CNG sales volumes (mscm)	1,028.0	1,073.1	1,132.5	1,177.6
PNG sales volumes (mscm)	356.0	330.5	343.4	355.0
CNG retail price (Rs/kg)	42.0	37.3	37.3	37.3
PNG retail price (Rs/scm)	30.2	31.7	30.5	30.5

Source: Company Data, PL Research.

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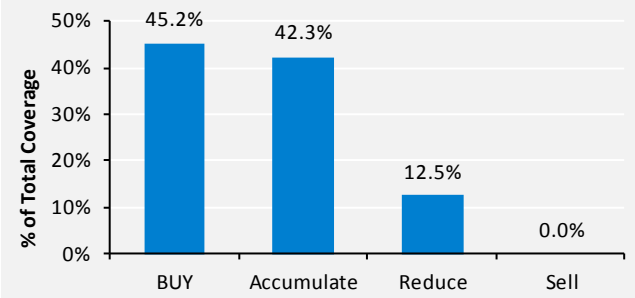

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BUY	:	Over 15% Outperformance to Sensex over 12-months
Accumulate	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months
Sell	:	Over 15% underperformance to Sensex over 12-months
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Trading Sell	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock
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