Equity Research
November 18, 2009
BSE Sensex: 17051

Oil & Gas and Petrochemicals

Target price Rs216

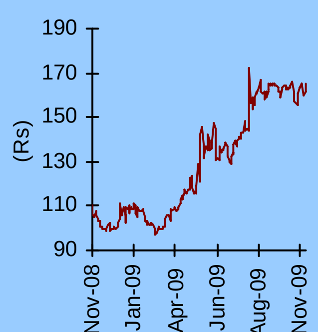
Target price revision
Rs216 from Rs193

Shareholding pattern

	Mar '09	Jun '09	Sep '09
Promoters	45.0	45.0	45.0
Institutional investors	35.4	33.0	33.5
MFs and UTI	14.1	13.7	13.7
FIs, Banks, Insurance Cos.	4.1	3.8	4.5
FIIs	17.2	15.5	15.3
Others	19.6	22.0	21.5

Source: NSE

Price chart



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INDIA

Indraprastha Gas

BUY
Maintained

At threshold of eminence

Rs164

Reason for report: Company update

"He who refuses to embrace a unique opportunity loses the prize as surely as if he had failed". – William James

Indraprastha Gas (IGL) is at the threshold of a huge boost given that the Government is set to notify Section 16 of the Petroleum & Natural Gas Regulatory Board (PNGRB) Act with suitable amendments in the Winter Session. Though these amendments are unknown, both our interaction with the industry and media reports suggest that the amendment would validate the earlier authorisation by any Central Government agency. Hence, IGL would get exclusive distribution rights for CNG & PNG in Gurgaon, Faridabad, Noida and Greater Noida – the National Capital Region (NCR). Besides, the interim decision of the Delhi High Court for city gas distribution (CGD) in Ghaziabad favoured IGL and the Court directed the company to start expanding its CNG footprint in the city. Allocation of Ghaziabad to IGL would improve visibility as regards geographical expansion. We value IGL's Delhi business at Rs160/share and the potential expansion in NCR at Rs56/share (FCFE). We raise our target price to Rs216 (by end FY10E) from Rs193. Maintain BUY.

- **Parliament to amend Section 16-PNGRB Act in Winter Session.** As per Mr RS Pandey, Secretary, Ministry of Petroleum & Natural Gas (MoPNG), the Government would notify Section 16 of the PNGRB Act in the Winter Session of the Parliament, starting from the third week of November.
- **IGL to get authorisation for five cities.** Both our interaction with the industry and media reports suggest that notification of Section 16 would have an amendment that entities previously authorised by Government agencies would be considered 'deemed authorised' under the PNGRB Act. NCR would contribute 3.5mmscmd in the long term, implying 3x growth in gas sales volumes for IGL in the next 7-8 years.
- **New business valued at Rs56/share with 31% upside.** We value NCR at Rs56/share based on FCFE and assuming that IGL sells 3mmscmd gas by FY16E, post Rs15bn capex. We continue to value IGL's Delhi region at Rs160/share, implying raised target price of Rs216/share and 31% upside from the current levels.

Market Cap	Rs23bn/US$483mn
Reuters/Bloomberg	IGAS.BO/IGL IN
Shares Outstanding (mn)	140
52-week Range (Rs)	182/95
Free Float (%)	55.0
FII (%)	15.5
Daily Volume (US$/'000)	1,605
Absolute Return 3m (%)	3.2
Absolute Return 12m (%)	49.4
Sensex Return 3m (%)	13.4
Sensex Return 12m (%)	90.8

Year to Mar	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	8,528	10,772	12,022	12,844
Net Income (Rs mn)	1,934	2,105	2,303	2,350
EPS (Rs)	13.8	15.0	16.4	16.8
% Chg YoY	10.9	8.8	9.4	2.0
P/E (x)	11.9	11.0	10.0	9.8
CEPS (Rs)	18.6	20.7	23.5	25.5
EV/E (x)	6.2	5.5	4.9	4.9
Dividend Yield (%)	2.4	2.4	2.4	2.4
RoCE (%)	28.9	26.3	24.2	21.0
RoE (%)	30.7	27.8	25.3	21.8

Expansion into NCR – Untapped potential

Why we believe IGL will get authorisation for new cities?

Mr. RS Pandey, Secretary (MoPNG), has indicated that the Parliament would be notifying Section 16 of the PNGRB Act in the coming Winter Session. He has further stated that the notification would be accompanied by suitable amendments.

Our interaction with MoPNG & the industry and media reports (www.indianpetro.com) suggest that the Ministry would add the following amendment – any entity previously authorised by the Central Government to operate CGD network in a city would be considered 'deemed authorised' under the new Act.

Notably, IGL has been authorised by the MoPNG to operate CGD in Gurgaon, Noida, Faridabad and Greater Noida. Moreover, Environmental Protection and Control Act (EPCA), another central Government Act had authorised IGL to operate a network in Ghaziabad.

Thus, we believe that the notification of Section 16 of the PNGRB Act along with the expected amendment would act as a significant trigger for IGL.

Huge untapped potential in new geographies

As per PNGRB, initial studies on the Ghaziabad market suggest a current potential demand of ~0.5mmscmd gas. In the long term, this is expected to grow to 1mmscmd. Similarly, Noida has a current demand of 0.1mmscmd, which would likely grow to 0.4mmscmd in the long term. Faridabad and Gurgaon also have combined potential demand of 1.9mmscmd. Including greater Noida, the new geographies could provide potential sales volumes of 3.5mmscmd, implying 12% volumes CAGR for IGL.

Table 1: Gas demand in National Capital Region

	Ghaziabad	Faridabad	Noida	Gurgaon
Population ('01)	0.97	1.05	0.30	0.40
Households ('01)	0.18	0.22	0.07	0.08
Vehicles ('04)				
Bus	7,228	30,357	3,158	11,574
Car	50,479	100,874	2,754	104,046
Auto	11,165	14,373	484	4,714
Demand (current)	0.50	0.30	0.10	0.30
Demand (long term)	1.00	0.80	0.40	1.12

Source: I-Sec Research, PNGRB, Industry

Introduction of CNG buses for Commonwealth Games, another boost

The high-capacity CNG segment, which includes buses, is also likely to get a fillip from the Delhi Government's proposal to introduce new CNG buses in the private sector. This is in preparation for the Commonwealth Games '10 and we expect additional 1,000 buses to ply in NCR over the next 18 months.

Huge capex plans to fast-track growth

IGL has planned a capex of Rs16bn in the next 3-4 years to improve its network infrastructure in NCR. The company may have to take Rs6bn debt in order to fund aggressive capex, which would reduce the cost of capital for IGL and improve valuations for the shareholders.

Reliance Industries' KG-D6 gas supply to sustain incremental growth

IGL may supply 2.2mmscmd, 2.5mmscmd and 2.7mmscmd gas in FY10E, FY11E and FY12E respectively in National Capital Territory alone. A further expansion into GNG would add to potential gas demand. However, the recent contract with Reliance Industries (RIL), wherein IGL can draw additional 0.3-2.1mmscmd from RIL's KG-D6 block, will help sustain incremental growth beyond APM gas allocation of 2mmscmd at present.

Potential upside from new geographies

Maintain BUY, fair value raised to Rs216

We maintain our extant business valuation at Rs160/share assuming 16% long-term RoCE, but value new geographies at Rs56/share. Our fair value at Rs216 offers 31% upside from the current price. Finalisation of the allocation in the next 3-6 weeks would be the key trigger and we expect a sharp run-up in the stock price in the short term.

Table 2: DCF value of extant business at Rs160/share

Risk free rate (%)	6.5
Market risk premium (%)	6.0
Beta of the stock	0.8
Cost of equity (%)	11.3
Gross cost of debt (%)	10.0
Tax rate (%)	34.0
Net cost of debt (%)	6.6
Target debt-to-capital	0.0
WACC (%)	**11.3**
Valuation (Rs mn)	
Terminal growth rate (%)	1.0
PV of FCF from FY11E to FY2017E	9,400
Terminal value	22,370
PV of terminal value	10,573
Firm value	19,973
Less FY10E net debt	(2,369)
NPV at end-FY10E	22,343
Number of equity shares outstanding (mn)	140
NPV at end-FY10E (Rs/share)	**160**

Source: I-Sec Research

Extant business valuations conservative

We believe our valuations for the extant business, assuming 16% long-term RoCE, may be conservative given the industry view that the companies may earn 3-4% higher returns vis-à-vis allowed returns by the regulator. Moreover, depreciation in the company's books is at a higher rate than what the regulator might consider for its calculations. Thus, IGL may post 17-18% RoCE in the long term, which would improve our March '10 target price for the extant business to Rs173-188/share.

Table 3: Sensitivity to extant business valuations

RoCE (%)	16	17	18
Fair value (Rs/share)	160	173	188
% change in fair value		8.1	17.5

Source: I-Sec Research

Automatic authorisation to circumvent competition

Automatic authorisation from the PNGRB would help IGL earn 14% RoCE on network infrastructure, while if competitive bidding was allowed, the eventual returns on network infrastructure would have been nil.

Moreover, IGL is saved from significant competition as the company would be able to maintain its 100% market share in the NCR. If any competitor would have acquired licences for these cities, the company would have faced competition in adjacent areas, especially around the city borders, which would have affected growth prospects.

New cities valued at Rs56/share

We value new cities in NCR (Ghaziabad, Noida, Greater Noida, Faridabad, Gurgaon) at Rs56/share for IGL based on FCFE-DCF, with implied ~15% average RoCE over FY11E-23E. We ascribe 4% terminal growth rate due to strong CGD demand expectations from these cities considering the households & vehicles population.

We assume that Rs15bn capex is required to develop CGD infrastructure in NCR and that Rs500mn normative capex is required going forward. We expect CGD network in new cities to require more than 3.5mmscmd gas in the long term as per PNGRB's study on gas demand in NCR (Table 1).

Table 4: FCFE- DCF value of new cities at Rs56/share

Cost of equity (%)	11.3
Terminal growth rate (%)	4.0
PV of FCFE from FY11E to FY2023E & terminal value (Rs mn)	7,855
Number of equity shares outstanding (mn)	140
NPV at end-FY10E (Rs/share)	**56**

Source: I-Sec Research

Risks

Competition post the Gas Policy. Beyond the marketing exclusivity, competition by other companies (setting up CNG stations within NCT) might affect IGL's market share and pressurise prices and margins. So, the period of exclusivity, if and when CNG comes under the regulator, would determine if this is a risk.

Fall in crude prices. Sharp fall in crude prices would lead to decline in competitiveness of CNG vis-à-vis substitutes (LPG, MS & HSD). This may impact IGL's growth prospects.

Failure to get land for further expansion of CNG outlets. If IGL is unsuccessful in getting land from the Government for expanding its CNG outlets, the company's growth plans might get affected, bringing earnings growth under pressure.

Financial Summary

Table 5: Profit and Loss statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Income (Sales)	**8,528**	**10,772**	**12,022**	**12,844**
Operating Expenses	**5,214**	**7,009**	**7,739**	**8,629**
EBITDA	**3,313**	**3,764**	**4,284**	**4,215**
% margins	*38.9*	*34.9*	*35.6*	*32.8*
Depreciation & Amortisation	674	796	986	1,216
Other Income	262	183	149	134
Recurring PBT	**2,901**	**3,151**	**3,447**	**3,133**
Add: Extraordinaries	(209)	-	-	-
Less: Taxes	967	1,046	1,145	783
- Current tax	997	1,082	1,184	783
- Deferred tax	(30)	(36)	(40)	-
Net Income (Reported)	**1,725**	**2,105**	**2,303**	**2,350**
Recurring Net Income	**1,934**	**2,105**	**2,303**	**2,350**

Source: Company data, I-Sec Research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Assets				
Total Current Assets	2,592	2,777	2,478	3,008
of which cash & cash eqv.	1,462	1,500	1,120	1,596
Total Current Liabilities & Provisions	1,536	1,512	1,620	1,740
Net Current Assets	**1,056**	**1,265**	**858**	**1,268**
Net Fixed Assets	**5,211**	**6,415**	**8,429**	**9,714**
Capital Work-in-Progress	816	1,000	1,500	1,250
Total Assets	**7,308**	**8,721**	**10,329**	**12,024**
Liabilities				
Borrowings	265	265	265	265
Deferred Tax Liability	209	173	133	133
Equity Share Capital	1,400	1,400	1,400	1,400
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	5,434	6,883	8,531	10,225
Net Worth	**6,834**	**8,283**	**9,931**	**11,625**
Total Liabilities	**7,308**	**8,721**	**10,329**	**12,024**

*excluding revaluation reserves

Source: Company data, I-Sec Research

Table 9: Quarterly trend

(Rs mn, year ending March 31)

	Dec-08	Mar-09	Jun-09	Sep-09
Net sales	2,204	2,285	2,339	2,738
% growth (YoY)	21	22	22	27
EBITDA	862	867	863	1,007
Margin (%)	39.1	38.0	36.9	36.8
Other income	57	54	50	43
Add: Extraordinaries	(116)	(94)	-	-
Net profit	499	497	483	568

Source: Company data, I-Sec Research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Cash flow	**2,359**	**2,681**	**3,099**	**3,432**
Working Capital Changes	(175)	(171)	26	66
Capital Commitments	(1,672)	(2,000)	(3,000)	(2,500)
Free Cash Flow	**512**	**511**	**126**	**998**
Cash flow from Investing Activities	**415**	**183**	**149**	**134**
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	-	-	-	-
Dividend paid	(655)	(560)	(560)	(560)
Extraordinary Items	**(209)**	**-**	**-**	**-**
Chg. in Cash & Bank balance	**271**	**39**	**(380)**	**476**

Source: Company data, I-Sec Research

Table 8: Key ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)				
EPS(Basic Recurring)	13.8	15.0	16.4	16.8
Diluted Recurring EPS	13.8	15.0	16.4	16.8
Recurring Cash EPS	18.6	20.7	23.5	25.5
Dividend per share (DPS)	4.0	4.0	4.0	4.0
Book Value per share (BV)	48.8	59.2	70.9	83.0
Growth Ratios (%)				
Operating Income	20.8	26.3	11.6	6.8
EBITDA	10.4	13.6	13.8	(1.6)
Recurring Net Income	10.9	8.8	9.4	2.0
Diluted Recurring EPS	10.9	8.8	9.4	2.0
Diluted Recurring CEPS	10.0	11.2	13.4	8.4
Valuation Ratios (x)				
P/E	11.9	11.0	10.0	9.8
P/CEPS	8.9	8.0	7.0	6.5
P/BV	3.4	2.8	2.3	2.0
EV / EBITDA	6.2	5.5	4.9	4.9
EV / Operating Income	2.4	1.9	1.7	1.6
EV / Operating FCF	9.4	8.2	6.7	5.9
Operating Ratio				
Raw Material/Sales (%)	44.5	47.0	47.7	50.4
Other Income / PBT (%)	9.0	5.8	4.3	4.3
Effective Tax Rate (%)	33.3	33.2	33.2	25.0
NWC / Total Assets (%)	(5.6)	(2.7)	(2.5)	(2.7)
Inventory Turnover (days)	16.3	18.8	18.1	18.7
Receivables (days)	10.3	10.8	11.5	11.8
Payables (days)	77.6	59.6	55.3	55.4
D/E Ratio (x)	3.1	2.1	1.3	1.1
Return/Profitability Ratio (%)				
Recurring Net Income Margins	22.7	19.5	19.2	18.3
RoCE	28.9	26.3	24.2	21.0
RoNW	30.7	27.8	25.3	21.8
Dividend Payout Ratio	29.0	26.6	24.3	23.8
Dividend Yield	2.4	2.4	2.4	2.4
EBITDA Margins	38.9	34.9	35.6	32.8

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10% outperformance; **HOLD**: -10% to +10% relative performance; **SELL**: +10% underperformance

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