

Company Flash

31 October 2007 | 6 pages

Indraprastha Gas (IGAS.BO)

Buy: 2Q – Yet Another Strong Quarter

- 2Q ahead of expectations** — IGL reported yet another operationally strong Q, with net income of Rs429m, +23% yoy, +12% qoq, and ahead of estimates.
- Strong core business growth** — Underlying business remained strong, with the continued rapid pace of private car conversions (c.3,000 per month), increasing PNG penetration, and geographical growth in newer areas such as Greater Noida and Ghaziabad resulting in overall volume growth of 12% yoy and 8% qoq. More importantly, operating margins remained steady at 43%. 1H EPS of Rs5.8 is trending at 50% of our full-year estimate, lending comfort to our forecasts, as volume growth remains robust.
- Resolution of Noida to provide fillip to growth** — The NOC from the UP government to operate in Noida is extremely positive, in our view. IGL plans to have c.5 stations operational there by March 2008. In addition to the steady growth being witnessed in Delhi, operating along the entire Delhi-Noida-Greater Noida corridor would provide a further fillip to volume growth (IGL currently sells just c.1.5mmscmd of its total contracted volumes of 2mmscmd).
- Reiterate Buy/Low Risk** — Continued growth in volumes in Delhi as well as geographic expansion, especially in Noida, should drive earnings growth over the next 3 years. This, combined with compelling valuations (the stock trades at 6.9x FY09E P/CEPS, a significant discount to peers which trade in the 9-11x range) and steady business performance, make IGL one of our top picks in the Indian gas utilities space. Maintain Buy/Low Risk with a target price of Rs160.

Buy/Low Risk	1L
Price (30 Oct 07)	Rs131.70
Target price	Rs160.00
Expected share price return	21.5%
Expected dividend yield	2.7%
Expected total return	24.1%
Market Cap	Rs18,438M US\$469M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	P/CEPS	ROE	Div. Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(x)	(%)	(%)
2006A	1,061	7.58	14.5%	17.3	4.9	11.3	30.7%	1.9%
2007A	1,380	9.85	30.0%	13.3	3.9	9.3	32.6%	2.3%
2008E	1,617	11.55	17.2%	11.4	3.2	8.1	31.1%	2.7%
2009E	1,836	13.12	13.6%	10.0	2.7	6.9	29.0%	3.0%
2010E	2,051	14.65	11.7%	9.0	2.2	6.1	26.9%	3.0%

Source: Powered by dataCentral

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2QFY08 Results Highlights

Figure 1. Indraprastha Gas – 2QFY08 Results (Rupees in Millions)

Year to 31-Mar	Q2FY07	Q1FY08	Q2FY08	% QoQ	% YoY	Comments
Net sales	1,542	1,618	1,741	7.6%	12.9%	Higher volumes + steady realizations
(Increase)/decrease in stock	(0)	(0)	0			
Consumption of raw materials	675	693	746	7.6%	10.5%	
Staff cost	36	36	35	-2.8%	-2.9%	
Other expenses	186	202	211	4.4%	13.5%	
Total expenditure	896	930	991	6.5%	10.6%	
EBITDA	645	687	750	9.2%	16.2%	
<i>EBITDA margin</i>	<i>41.9%</i>	<i>42.5%</i>	<i>43.1%</i>			Strong operating margins maintained
Interest	0	0	0			
Depreciation	(150)	(156)	(158)	1.7%	5.3%	
Other income	23	40	47	18.8%	107.1%	
Profit before tax	518	571	639	11.9%	23.4%	
Current tax	(170)	(187)	(211)	12.6%	23.8%	
<i>Tax rate</i>	<i>32.9%</i>	<i>32.8%</i>	<i>33.0%</i>			
Net income	348	384	429	11.5%	23.2%	
Operational parameters						
CNG						
- Sales (Rs m)	1,630	1,690	1,816	7.4%	11.4%	
- Volumes ('000 tonnes)	86	89	96	7.4%	11.2%	Growth aided by private car conversions
- CNG Realization (Rs/kg)	19.0	19.0	19.0	0.0%	0.2%	Steady realizations as no price hike since Jun-06
PNG						
- Sales (Rs m)	143	169	185	9.7%	29.1%	
- Volumes (mmscm)	8.8	9.6	10.5	9.4%	19.3%	Growth remains healthy as penetration improves
- PNG Realization (Rs/scm)	16.3	17.6	17.6	0.3%	8.2%	
Total volumes (mmscm)	121.3	126.0	135.6	7.6%	11.8%	

Source: Company Reports and Citi Investment Research

Indraprastha Gas

Company description

BPCL and GAIL floated Indraprastha Gas (IGL) with a 22.5% stake each. IGL is the sole supplier of Compressed Natural Gas (CNG) to the automotive sector and Piped Natural Gas (PNG) to the domestic and commercial sectors in the National Capital Territory of Delhi. It has a first-mover advantage in this business in Delhi, as there are high barriers to entry in the business including sourcing of gas, investment in building out of distribution networks, and statutory approvals for roll-out of networks. IGL gets 1.4mmscmd of gas from GAIL (of an allocated 2mmscmd) — 90% of the gas is sold as CNG to the auto sector and 10% as piped natural gas to domestic and commercial users. IGL's skew towards CNG is due to the Supreme Court's ruling that makes it mandatory for all public-transport vehicles in the National Capital Territory to use CNG.

Investment strategy

We retain our Buy/Low Risk (1L) rating and target price of Rs160. We see three drivers of volume growth for IGL: (1) growth in PNG penetration, with renewed focus as compliance-led skew towards CNG should moderate; (2) geographical growth in the National Capital Region; and (3) discretionary demand growth. Although retail gas demand was kick-started by legislative measures, superior gas economics would also be leading to higher growth in discretionary demand. We expect strong demand growth and continuing high retail margins to drive a 14% CAGR in earnings over FY07-10E.

Valuation

Our target price of Rs160 for IGL is based on DCF. We prefer to use DCF, as it captures the value of the projects over their lifetime. IGL's near-term cash flow is affected by its aggressive expansion. In our DCF analysis, we have used explicit forecasts for four years, a terminal growth rate of 2%, and a WACC of 10.9% (based on a stock beta of 0.6). Our target P/CEPS of 8.2x FY09E is still at a discount to current multiples of other gas utilities, which we believe is very reasonable given the higher capital returns parameters and lower regulatory scrutiny on margins. We prefer to use P/CEPS as a comparison due to the utility nature of IGL's business and the high depreciation rates on its assets.

Risks

We rate IGL Low Risk based on our quantitative risk-rating system. The downside risks to our target price include: (1) stronger-than-anticipated growth in alternative modes of public transport could impact CNG demand; (2) delays in conversion of LCVs to CNG could also impact demand; (3) further deregulation/hike in administered gas prices, with no corresponding hike in CNG prices, could put pressure on margins; and (4) delays in implementation of projects in the NCR region could impact PNG volume growth.

Appendix A-1

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Analyst: Saurabh Handa (covered since June 5 2007)



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