

Company Flash

31 January 2008 | 6 pages

Indraprastha Gas (IGAS.BO)

Buy: Strong 3Q as Volume Growth Continues

- 3Q profits up 27% yoy** — Indraprastha Gas reported a strong set of 3QFY08 numbers, with net income growing 27% yoy to Rs450m, in line with our estimate, driven by sustained volume growth in both CNG and PNG.
- Robust operating margins sustained at 43%** — This was in line with the run rate over the last few Qs. Underlying business remained strong with increasing PNG penetration (volumes up 18% yoy) and robust growth in CNG sales (volumes up 13% yoy; private car conversions trending at c.3,000 per month).
- Noida to start contributing in FY09E** — Noida operations will provide a fillip to volume growth from FY09E, with c.5 stations likely to be operational by Mar-08. Increasing contribution from newer areas such as Ghaziabad and Greater Noida should further add to volume growth, as supplies are not a concern (sales of 1.5mmscmd out of 2mmscmd of total contracted volumes).
- Reiterate Buy/Low Risk** — While still at a draft stage, recent city gas distribution regulations should be beneficial for the sector as a whole as new area licensing, network tariffs, etc. come under the purview of one regulatory authority, improving transparency and spurring development of the as-yet nascent sector. Though 3 years marketing exclusivity (from Oct-07) for incumbents is lower than expected, first-mover advantage and rapid network expansion create sufficient entry barriers for potential new entrants. After correcting ~30% from recent highs, IGL now trades at 6.8x FY09E P/CEPS, a significant discount to peers (11-13x), making valuations look compelling, esp. in light of sustained, robust business performance.

Buy/Low Risk	1L
Price (31 Jan 08)	Rs129.10
Target price	Rs160.00
Expected share price return	23.9%
Expected dividend yield	2.7%
Expected total return	26.6%
Market Cap	Rs18,074M
	US\$460M

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



Statistical

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,061	7.58	14.5	17.0	4.8	30.7	1.9
2007A	1,380	9.85	30.0	13.1	3.9	32.6	2.3
2008E	1,617	11.55	17.2	11.2	3.2	31.1	2.7
2009E	1,836	13.12	13.6	9.8	2.6	29.0	3.1
2010E	2,051	14.65	11.7	8.8	2.2	26.9	3.1

Source: Powered by dataCentral

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3QFY08 Results Highlights

Figure 1. Indraprastha Gas – 3QFY08 Results (Rupees in Millions)

Year to 31-Mar	Q3FY07	Q2FY08	Q3FY08	% QoQ	% YoY	Comments
Net sales	1,599	1,741	1,827	5.0%	14.3%	Strong volume growth, steady realizations
(Increase)/decrease in stock	(0)	0	(0)	-	-12.1%	
Consumption of raw materials	721	746	780	4.7%	8.3%	
Staff cost	36	35	40	14.7%	9.4%	
Other expenses	188	211	227	7.7%	20.6%	
Total expenditure	945	991	1,047	5.7%	10.8%	
EBITDA	654	750	780	4.0%	19.4%	Robust margins sustained during the quarter
<i>EBITDA margin</i>	<i>40.9%</i>	<i>43.1%</i>	<i>42.7%</i>			
Interest	0	0	0			
Depreciation	(150)	(158)	(161)	1.6%	7.4%	
Other income	24	47	58	22.0%	141.7%	
Profit before tax	528	639	678	6.0%	28.3%	
Taxation	(173)	(211)	(227)	7.8%	20.1%	
<i>Tax rate</i>	<i>32.8%</i>	<i>33.0%</i>	<i>33.6%</i>			
Net income	355	429	450	5.1%	26.9%	
Operational parameters						
CNG						
- Sales (Rs m)	1,686	1,816	1,907	5.0%	13.1%	Stable growth maintained, driven by private car conversions
- Volumes ('000 tonnes)	89	96	100	4.9%	12.8%	
- CNG Realization (Rs/kg)	19.0	19.0	19.0	0.1%	0.2%	Steady realizations
PNG						
- Sales (Rs m)	152	185	193	4.3%	26.7%	Steadily improving penetration
- Volumes (mmscm)	9.1	10.5	10.7	1.9%	17.6%	
- PNG Realization (Rs/scm)	16.7	17.6	18.0	2.4%	7.7%	Improving realizations as mix improves
Total volumes (mmscm)	121.5	135.6	141.9	4.6%	16.8%	CNG constitutes 92% of total volumes

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 small 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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