Company Flash

27 June 2006 | 5 pages

# Indraprastha Gas (IGAS.BO)

## LCV Notification At Last

- What's new? — The government of Delhi has notified that all Light Commercial Vehicles registered in Delhi from 1 July 2006 would have to run on CNG. This should be a key factor driving CNG demand for IGL.
- Factored in estimates but significant trigger — The notification is likely to be an important positive trigger for the stock. We have factored in robust growth in CNG demand in our forecast premised on demand growth from the LCV segment and greater conversion of private cars to CNG.
- Cost increases passed through, another positive — IGL raised prices of CNG by 6.7% (to Rs19.2/kg) in early June, passing through increase in input gas prices (+20% to Rs3,840/tscm), dealer commissions and higher administrative costs. Though PNG prices were held constant, we believe the net impact of the CNG price hike will be slightly positive for IGL's margins.
- Retain Buy — Introduction of mandatory conversion of new light commercial vehicles to CNG provides further support to our robust earnings growth forecast. We retain our Buy rating with a target price of Rs156.

| | |
|---|---|
| **Buy/Low Risk** | **1L** |
| Price (27 Jun 06) | Rs105.00 |
| Target price | Rs156.00 |
| Expected share price return | 48.6% |
| Expected dividend yield | 1.9% |
| **Expected total return** | **50.5%** |
| Market Cap | Rs14,700M |
| | US$318M |

Figure 1. Statistical Abstract

| Year to 31 Mar | Net Profit (RsM) | Diluted EPS (Rs) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|---|---|---|---|---|---|---|---|
| 2004 | 822 | 5.87 | 52.2 | 17.9 | 5.8 | 36.9 | 1.4 |
| 2005 | 927 | 6.62 | 12.7 | 15.9 | 4.7 | 32.9 | 1.9 |
| 2006E | 1,012 | 7.23 | 9.2 | 14.5 | 3.8 | 29.1 | 1.9 |
| 2007E | 1,200 | 8.57 | 18.6 | 12.2 | 3.1 | 28.2 | 2.1 |
| 2008E | 1,504 | 10.75 | 25.4 | 9.8 | 2.6 | 28.8 | 2.7 |

Source: Citigroup Investment Research

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See page 3 for Analyst Certification and important disclosures.



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# 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 1.2mmscmd of gas from GAIL (of an allocated 2mmscmd) — 95% of the gas is sold as CNG to the auto sector and 5% as piped natural gas to domestic and commercial users. IGL's skew toward 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 Thesis

We retain our Buy (1L) rating and target price of Rs156. We see four drivers of volume growth for IGL: (1) growth in PNG penetration, with renewed focus as compliance-led skew toward CNG should moderate; (2) regulatory upside potential, with the Delhi government likely to mandate conversion of LCVs to CNG; (3) geographical growth in the National Capital Region; and (4) 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 20% CAGR in earnings over FY05-08E.

## Valuation

Our target price of Rs156 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 five years, a terminal growth rate of 2%, and a WACC of 10.7% (based on a stock beta of 0.89). Our target price for IGL is also based on a Price/Cash Earnings of 11.3x FY07E. We prefer to use P/CE as a secondary valuation method to value IGL due to the utilities nature of its business and the high depreciation rates on its assets. Our target P/CE is at a 20% premium to GAIL, which we believe is justified, given the higher capital returns parameters and lower regulatory scrutiny on margins. We also believe that IGL's business model faces lower cyclicality vis-à-vis GAIL, which has material contributions from the petrochemical and LPG business. Besides, GAIL has to bear a small portion of oil marketing losses, which is not the case with IGL.

## 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 the inclusion of LCVs for conversion 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.

# Analyst Certification Appendix A-1

**We, Pradeep Mirchandani, CFA and Rahul Singh, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.**

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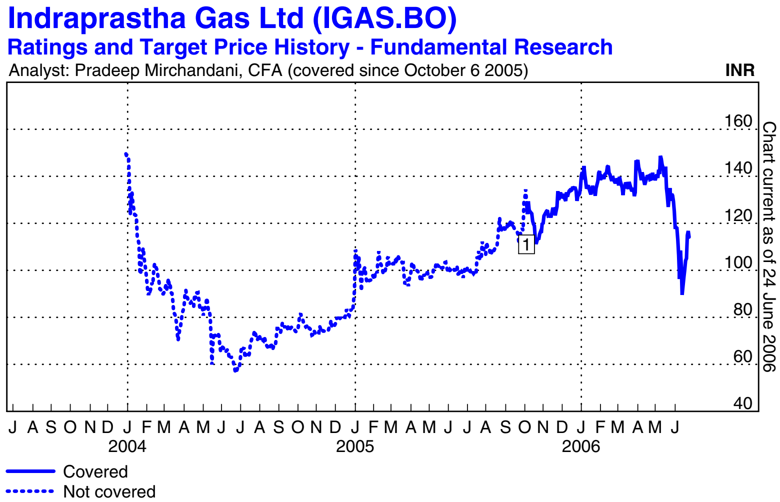


| # | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1: | 5 Oct 05 | 1L | 156.00 | 128.50 |

*Indicates change.

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|---|---|---|---|
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| *% of companies in each rating category that are investment banking clients* | 45% | 42% | 33% |
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