KARVY STOCK BROKING

Oil & Gas

January 03, 2013

Institutional Equities
India Research

Indraprastha Gas

COMPANY UPDATE

Bloomberg: IGL IN
Reuters: IGAS.BO

BUY

Amidst Uncertainties, Lies Value

The ongoing legal conflict on authorization of a regulatory body for CGD (City Gas Distribution) entities between PNGRB and Indraprastha Gas Ltd (IGL) post tariff cut, has hit IGL's valuation severely in the last 3 quarters. Currently trading at 11x FY14E as against historical band of 17-18x and immediate peer Gujarat Gas trading at 15x, we see rerating potential in the stock. This valuation gap is unwarranted as the regulatory uncertainties are not as grave as it has been priced in. We believe earnings are unlikely to take a major hit, even though Apex court goes in favor of PNGRB.

Supreme Court Hearing to Address the Authorization Issue: The hearing scheduled in March is going to address the authorization of PNGRB for determining tariff of CGD entities, which had been challenged by IGL at the High Court. However, the tariff cut is scheduled to be reviewed every five years (scheduled next year) and can also be challenged at the Tribunal Level. Currently IGL's tariff doesn't seem to be violating regulatory requirements.

As Per the HC Hearing, PNGRB's Authorization to Determine Tariff is Limited to Gas Transporters: The PNGRB Act authorizes PNGRB to regulate tariffs of transporters/carriers of natural gas (e.g: Gail India, GSPL) and not the marketers of natural gas, who own the distribution network, buy natural gas and sell it in compressed form. PNGRB's authorization over CGD entities demands amendment in the Act. As per the existing Act, the tariff cut should be applicable to the third party carriers using IGL's network, which contributes negligible portion of IGL's earnings currently.

Irrespective of Supreme Court Judgment; there lies value: Retrospective implication of tariff cut even if the Apex court favors PNGRB seems to be unfeasible, thus a major hit to the cash flow is ruled out. Similarly earnings/tariff is unlikely to take a major hit based on existing provisions in the Act. IGL seems to be attractively valued at 11x due to regulatory uncertainties vis-à-vis Gujarat Gas at 15x. However, we believe the uncertainties are not as worrying as it is being factored in stock price. Our valuation arrives at 320 at 14x (EPS Rs. 23/share), with EBITDA of Rs. 4.5/scm (Rs. 6/scm in 2QFY13). We assign BUY rating to IGL with a target price of Rs. 320 viewing regulatory uncertainties as an opportunity for value pick.

Key Financials

Y/E Mar (Rs mn)	FY10	FY11	FY12	FY13E	FY14E
Operating income	10,780	17,441	25,178	34,168	41,757
EBITDA	3,807	4,922	6,345	7,250	7,198
EBITDA margin (%)	35.3	28.2	25.2	21.2	17.2
PAT	2,154	2,597	3,064	3,478	3,188
PAT margin (%)	20.0	14.9	12.2	10.2	7.6
EPS(Rs)	15.4	18.5	21.9	24.8	22.8
P/E (x)	16.3	13.5	11.5	10.1	11.0
EV/EBITDA (x)	9.0	8.0	6.4	5.7	5.9
P/BV(X)	3.2	2.3	1.6	1.2	1.0

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs251
Target Price:	Rs320
Upside (%)	28%

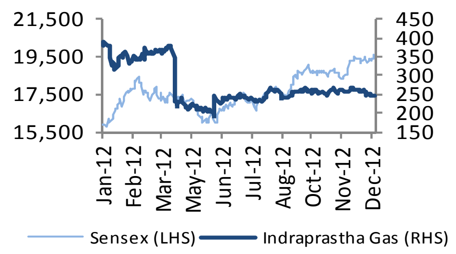
Stock Information

Market Cap. (Rs bn / US$ mn)	35/646
52-week High/Low (Rs)	394/170
3m ADV (Rs mn /US$ mn)	123/2.3
Beta	0.6
Sensex/ Nifty	19,714/5,993
Share outstanding (mn)	140

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(5.7)	(5.6)	(32.9)	0.7
Rel. to Sensex	(7.5)	(9.9)	(47.2)	(0.7)

Performance



Source: Bloomberg

Analysts Contact

Vinay Nair
022 6184 4319
vinaynair@karvy.com

What we Perceive of the Ongoing Conflict between PNGRB and IGL

HC Judgment Questions the Authority of PNGRB over Tariff Determination of CGD entities

Our interaction with the management suggests, IGL has challenged PNGRB on the Act level and not on the Regulation front. The Act authorizes PNGRB to authorize and determine network tariff of common carriers of natural gas through pipelines. However, CGD entities are not simply the contract carriers but the owner of the distribution network wherein they buy natural gas from producers, compress it and sell it to the consumers through its own distribution network.

Excerpts of Relevant Provisions in the PNGRB Act:

Section 11 of the Act Provides Following Clauses

Functions of the Board:

The Board shall-

e) *Regulate by regulations*

  ii) *transportation rates for common carrier or contract carrier*

  vi) *monitor transportation rates and take corrective action to prevent restrictive trade practice by the entities*

Section 2 of the Act Defines "transportation rate" as:-

"transportation rate", in relation to common carrier or contract carrier or a city or local natural gas distribution network, means such rate for moving each unit of petroleum, petroleum products or natural gas as may be fixed by regulations."

Section 22 of the Act provides for Transportation tariff as under:-

1. *Subject to the provisions of this Act, the Board shall lay down, by regulations, the transportation tariffs for common carriers or contract carriers or city or local natural gas distribution network and the manner of determining such tariffs.*
2. *For the purposes of sub-section (1) above, the Board shall be guided by the following, namely:-*
   (a) *the factors which may encourage competition, efficiency, economic use of the resources, good performance and optimum investments;*
   (b) *safeguard the consumer interest and at the same time recovery of cost of transportation in a reasonable manner;*
   (d) *the connected infrastructure such as compressors, pumps, metering units, storage and the like connected to the common carriers or contract carriers;*
   (f) *policy of the Central Government applicable to common carrier, contract carrier and city or local distribution natural gas network"*

Thus the Act contemplates an entity engaged only in laying down and maintaining such network alone without being a marketer of gas and which entity has been described as a contract carrier. Hence, based on the existing provisions of the Act, if Supreme Court passes judgment in favor of PNGRB, the tariff will be applicable only to the common carriers through IGL's network. Currently third party contribution (common carriers) is negligible in IGL's earnings.

The transportation tariff mentioned in the Act is the rate/tariff charged by one entity from another and not the rate/tariff which marketer of gas charges from the consumers. Thus, based on HC judgment, PNGRB Act needs to be amended in order to bring CGD entities under the ambit of PNGRB for determination of network tariff.

Similarly, the Act doesn't Empower PNGRB to Fix Final Retail Prices…

Section 11 of the Act Provides Following Clauses Under the Head Functions of the Board:

(a) Protect the interest of consumers by fostering fair trade and competition amongst the entities;

(f) in respect of notified petroleum, petroleum products and natural gas-

- *(ii) ensure display of information about the maximum retail prices fixed by the entity for consumers at retail outlets;*
- *(iii) monitor prices and take corrective measures to prevent restrictive trade practice by the entities;*

The Act doesn't empower PNGRB to fix final retail prices to be charged by CGD entities on users either. It is entitled to interfere and take corrective measures for the final prices of the entity only if they indulge in unfair and restrictive trade practices. However, there have been no complaints as regards unfair trade practice on pricing front on IGL.

Earnings Unlikely to take a Major Hit; as there is enough Room to Protect Tariff

If SC calls for amendment in the Act in order to bring CGD entities under the ambit of PNGRB for determining tariff and passes judgment in PNGRB's favor, there is still room for averting major impact of tariff cut on the earnings. The SC hearing would be passing judgment only referring to authorization issue and not the tariff cut. The tariff cut could be challenged separately at the Tribunal level based on actual datas.

Besides, PNGRB tariff is always subject to revision and audit every five years. Since PNGRB determined tariff in April 2012 - three years post PNGRB incorporation - the tariff is subject to revision by next year based on actual expenditure incurred in five years, and the new tariff will be applicable from the sixth year.

Valuation Gap between Gujarat Gas and IGL Seems to be Unwarranted

Concerns over Regulatory Uncertainties not as Grave as Stock Price seems to be factoring in

The primary reason for valuation gap between IGL and Gujarat Gas (11x and 15x respectively) is the uncertainty over the tariff determination and SC judgment for IGL. However, based on our analysis above, the earnings are unlikely to take a major hit. Besides, any judgment would be having an implied effect on the earnings of Gujarat Gas also as it will also come under the ambit of PNGRB. Thus, GSPC's acquisition of British Gas's (BG) 65.12 % stake in its Indian subsidiary Gujarat Gas Company at Rs295/shr (15x CY13E) seems to be pricing in the uncertainties associated.

Cheaper Valuations Despite better fundamentals

Plainly based on valuations of BG's stake sale in Gujarat Gas, we suggest that any further correction in IGL could be taken as an opportunity to buy as it seems to be better defensive pick with limited downside as compared to Gujarat Gas in CGD space.

IGL has an upper hand in many variables as compared to Gujarat Gas:

1) Higher volume growth of 12-13%(vis-à-vis 4-5% growth in Gujarat gas)
2) Post BG exit, IGL has upper hand in sourcing gas
3) Higher command over margins as liberty to pass through the cost is higher in CNG as compared to industrial gas.

Institutional Equities Team

Rangachari Muralikrishnan	**Head – Institutional Equities / Research / Strategy**	**+91-22 61844301**	**muralikrishnan@karvy.com**
K. Anant Rao	**Head - Sales-Trading & Derivatives**	**+91-22 61844303**	**k.anantrao@karvy.com**
Uday Raval	**Karvy Inc. USA**	**+1 212 2674334**	**udayr@karvy.com**

INSTITUTIONAL RESEARCH

Analysts	Industry / Sector	Desk Phone	Email ID
Amey Chalke	Pharmaceuticals	+91 -22 61844325	amey.chalke@karvy.com
Dwaipayan Poddar	Chief Technical Strategist	+91-22 61844372	dwaipayan.poddar@karvy.com
Hatim Broachwala, CFA	Banking	+91-22 61844329	hatim.broachwala@karvy.com
Kruti Shah	Economist	+91-22 61844320	kruti.shah@karvy.com
Manoj Kumar Manish	Derivatives and Quant Analyst	+91-22 61844327	manojkumar.m@karvy.com
Maruti Kadam	Automobiles / Metals & Mining	+91-22 61844326	maruti.kadam@karvy.com
Mitul Shah	Automobiles	+91-22 61844312	mitul.shah@karvy.com
Naveen Trivedi	FMCG	+91-22-61844316	naveen.trivedi@karvy.com
Pallav Agarwal	Metals & Mining	+91-22 61844317	agarwal.pallav@karvy.com
Paresh Jain	BFSI	+91-22 61844324	paresh.jain@karvy.com
Parikshit Kandpal	Infra / Real Estate / Strategy	+91-22 61844311	parikshit.kandpal@karvy.com
Rahul Sharma	Pharmaceuticals	+91-22 61844310	rahul.sharma@karvy.com
Rahul Singh	MidCap	+91-40-44857911	rahulsingh@karvy.com
Rajesh Kumar Ravi	Cement & Logistics	+91-22 61844313	rajesh.ravi@karvy.com
Rupesh Sankhe	Power/Capital Goods	+91-22 61844315	rupesh.sankhe@karvy.com
Vinay Nair	Oil & Gas	+91-22 61844319	vinaynair@karvy.com

INSTITUTIONAL SALES

Dinesh Bajaj	Sales	+91-22 61844341	dinesh.bajaj@karvy.com
R. Sriram	Sales	+91-22 61844340	sriram.rangarajan@karvy.com
Shabbir Dahodwala	Sales (USA)	+1-212-2674334	shabbir@karvy.com
Tejash Gandhi	Sales	+91-22 61844345	tejash.gandhi@karvy.com

INSTITUTIONAL SALES TRADING & DEALING

Bhavesh Gandhi	Institutional Dealer	+91-22 61844368 /69	bhavesh.gandhi@karvy.com
Prashant Oza	Institutional Dealer	+91-22 61844370 /71	prashant.oza@karvy.com
Parag Shah	Sales Trader	+91-22 61844364 /65	parag.shah@karvy.com
Sriram Jagdish	Sales Trader	+91-22 61844366 /67	sriram.jagdish@karvy.com
Gurdarshan Singh Kharbanda	Sales Trader	+91-22-61844368 / 69	gurdarshansingh.k@karvy.com

PRODUCTION

Asim Kumar Mohapatra	Editor	+91-22 61844318	asim.mohapatra@karvy.com
Vishal Randive	Database Analyst	+91-22 61844321	vishal.randive@karvy.com
Vijayalaxmi Moolya	Production	+91-22 61844328	vijayalaxmi.m@karvy.com

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

For further enquiries please contact:

research@karvy.com

Tel: +91-22-6184 4300

Disclosures Appendix

Analyst certification

The following analyst(s), who is (are) primarily responsible for this report, certify (ies) that the views expressed herein accurately reflect his (their) personal view(s) about the subject security (ies) and issuer(s) and that no part of his (their) compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.

Disclaimer

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and upon sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it. The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor Karvy Stock Broking nor any person connected with any associate companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above mentioned companies from time to time. Every employee of Karvy and its associate companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd. This report is intended for a restricted audience and we are not soliciting any action based on it. Neither the information nor any opinion expressed herein constitutes an offer or an invitation to make an offer, to buy or sell any securities, or any options, futures nor other derivatives related to such securities.