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Indraprastha Gas Ltd.

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Incorporated in 1998, Indraprastha Gas Ltd (IGL) is the sole supplier of Compressed Natural Gas (CNG) and Piped Natural Gas (PNG) in the National Capital Region. The company is a joint venture between GAIL (India) Ltd and Bharat Petroleum Corporation Ltd.

Investment Rationale

Priority allocation directive by the government improves outlook: The latest government order for priority allocation of domestically produced natural gas is encouraging for the company as it holds the sole authority of supplying natural gas in NCR. We anticipate sales to increase in the long run because higher volumes from PNG segment (industrial volumes) and lower LNG prices. ***Nonetheless, in the shorter term, the cost advantage of CNG over diesel will ensure steady growth of CNG.***

Full benefits of restructuring to be visible from FY16: IGL's sales volume has seen an uptrend since last five years. It has shown an accumulative increase in the PNG and CNG volumes growing from 789 mmscm in FY10 to 1384 mmscm in FY14 on account justified by the government's focus on CNG and PNG, expected rise in domestic gas production in medium to long term and lower current RLNG prices.

We are of the view that the company has ample opportunities of growth going further as well on the back of growing acceptance of cost-effective CNG in the auto sector along with household and industrial use.

Economical tie-ups bode well for growth: The forthcoming development strategies of the company are extremely dependent on its ability to tie-up cost competitive new sources of gas. To achieve this, the company intends to carry on with expansion strategies mainly inorganic acquisitions that will help it increase its foothold in other markets than NCR and subsequently aid in profitability.

Tussle with PNGRB may bring downside risks: The downstream regulator Petroleum and Natural Gas Regulatory Board (PNGRB) has issued an order determining the transmission tariff and compression charges for IGL's city gas distribution (CGD) network in Delhi. As per the order, PNGRB has approved a significantly lower compression charge of ₹2.8/kg (vs. ₹6.7/kg as proposed by IGL) and network tariff of ₹38.6/mmBtu vs. ₹104.1/mmBtu as proposed by IGL retrospectively from April, 2008. Thus, the combined new tariff is around 60% lower than proposed by the IGL. ***A case regarding the same is pending in the Supreme Court which if results in unfavorable decision will affect margins adversely.***

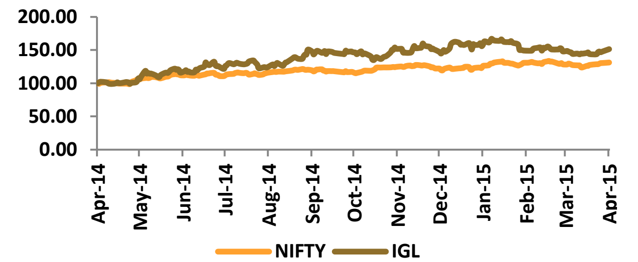
Market Data

Rating	**BUY**
CMP (₹)	422.0
Target (₹)	**521**
Potential Upside	~24%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	489.0/239.5
Adj. all time High (₹)	489.0
Decline from 52WH (%)	13.8
Rise from 52WL (%)	52.2
Beta	0.3
Mkt. Cap (₹bn)	59.0
Enterprise Value (₹bn)	59.7

Fiscal Year Ended

Y/E Mar	FY14A	FY15E	FY16E	FY17E
Revenue (₹bn)	39.2	40.0	40.9	41.7
Net Profit (₹bn)	3.6	4.8	5.2	5.3
Share Capital (₹bn)	1.4	1.4	1.4	1.4
EPS (₹)	25.7	34.6	37.2	38.0
PE (x)	16.4	12.2	11.3	11.1
P/BV (x)	3.3	2.7	2.3	2.0
EV/EBIDTA(x)	7.6	7.1	6.3	5.9
RoCE (%)	27.1	28.3	26.2	23.5
RoE (%)	20.4	22.5	20.1	17.6

One year Price Chart



Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	45.0	45.0	-
FII	15.6	13.7	1.9
DII	22.8	23.8	(1.0)
Others	16.6	17.5	(0.9)

Indraprastha Gas ltd. - Dominating the NCR market

IGL enjoys the stature of being the sole supplier of CNG and PNG in Delhi/NCR

The company has impressive clientele of high end players like Britannia, Pearl Industries, etc.

The Company had a network of 325 stations for supply of CNG as on March 31, 2014.

Incorporated in 1998, Indraprastha Gas Ltd (IGL) is the sole supplier of Compressed Natural Gas (CNG) and Piped Natural Gas (PNG) in the National Capital Region. The company is a joint venture between GAIL (India) Ltd and Bharat Petroleum Corporation Ltd. Its unique business model is a result of various business transfers, strategic modifications and client acquisitions giving the company an early-bird advantage in the market. In June 9, 2000, the company signed an asset transfer agreement with GAIL in which the business of distribution of natural gas, liquefied petroleum gas and compressed natural gas along with the land and buildings, licenses, permits, authorizations, customer lists contacts were transferred from GAIL to the company. During the year 2003-04, the company laid and commissioned 20 kms of 4 Dia steel pipelines to make 16 CNG stations on-line. During the year 2005-06, the company entered into an agreement with BPCL for supply of R-LNG on a long-term basis. The company commenced their supply of R-LNG to Britannia Industries, Haldiram's, and Pearl Drinks etc. In October 2007, the company started project execution activities in the town of Noida. The company has laid 12 Kms and 22 Kms of steel pipeline in Noida and Greater Noida respectively.

Currently, in Ghaziabad, the company has been allotted 2 sites for CNG stations for which project execution activities are under implementation. The company also plans to supply CNG through retail outlets of Oil Marketing Companies during the financial year 2008-09.

In Haryana, the company made a joint venture company with Siti Energy Ltd and in the process of setting up City Gas Distribution Projects in the towns of Sonepat & Panipat. The company is looking to expand their network to other neighbouring cities like Chandigarh, Panipat, Sonepat, Rohtak, Bulandshahr, Ghaziabad and Meerut.

The Company has a network of 325 stations for supply of CNG as on March 31, 2014. The estimated number of vehicles using CNG was over 7 lakhs in March 2014 and their back-end infrastructure, compression capacity and dispensing outlets are under continuous augmentation to meet the growing demand.

The Company has provided PNG connections to 4.6 lakhs domestic households and around 1875 commercial & industrial customers as on March 31, 2014.

No. of CNG Vehicles serviced by IGL

	FY11	FY12	FY13	FY14	9MFY15
Buses	16,655	18,839	18,826	19,566	19,975
Auto	121,854	159,123	193,852	206,352	219,536
RTV	11,070	13,007	14,062	14,039	13,040
Cars	281,802	359,176	460,926	514,801	546,273
Total	431,381	550,145	687,666	754,758	798,824

No. of PNG pipelines laid by IGL over the years

Category	FY11	FY12	FY13	FY14	9MFY15
Steel Pipeline	421	574	631	658	674
MDPE Pipeline	4,420	6,479	7,783	8,438	8,803
Total	2,629	4,841	7,053	8,414	9,477

Q3FY15 remained a mixed bag

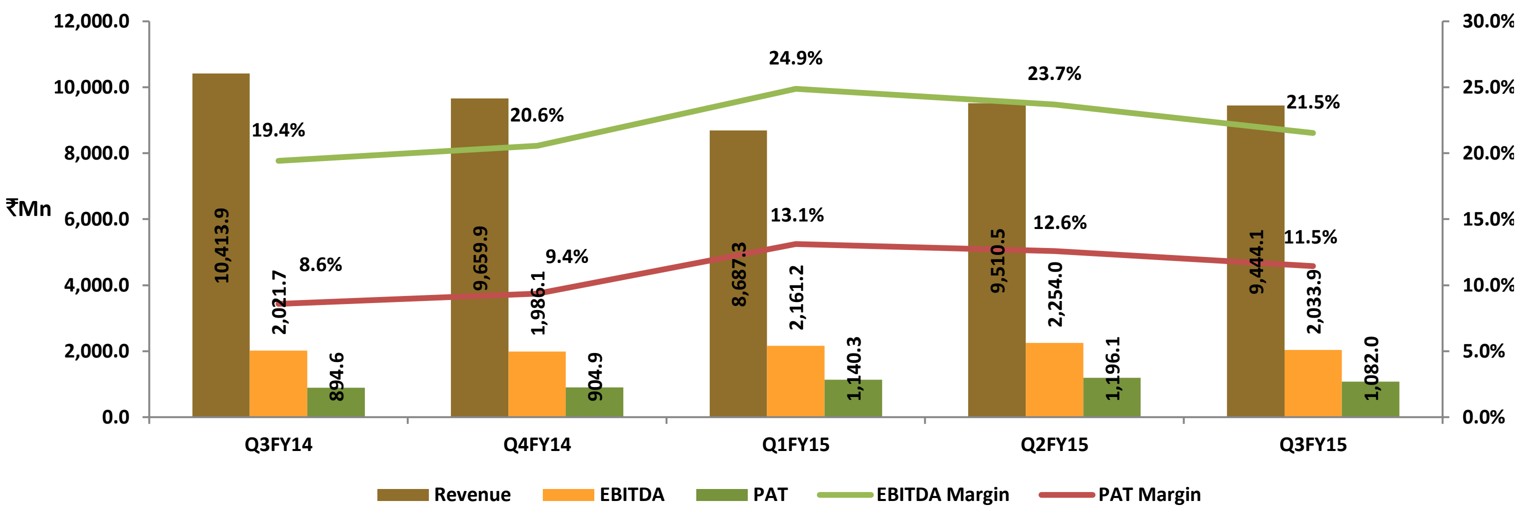
The company's total income decreased 9.3% YoY in Q3FY15 on the back of lower volumes and weaker realisations.

Revenue declined due to lower realisations: IGL's top-line was marred by the double whammy of lower overall growth in sales volume and declining realisations accounting for the slashed CNG prices. The top-line declined 9.3% YoY reported at ₹9,444.1 mn in Q3FY15.

The CNG sales volumes standing at 3.01 MMSCMD increased 5.7% YoY during the quarter but decreased 1.5% on a sequential basis. On the other hand, PNG volumes reported at 0.92mmscmd declined 7.6% YoY and 4.2% QoQ, compressed by demand slowdown in the industrial/commercial segments. Overall volumes grew 2.2% YoY from 346.5 mmscm to 354.1 mmscm. Reasons attributable to the declining sales volumes are:

- IGL has been serving the Delhi/NCR market for quite a while now and the market growth seems to have stagnated resulting in lower sales.
- Owing to the steep drop in oil prices, PNFG and CNG are no longer competitive on the price frontier making private vehicle conversion to CNG difficult.
- IGL's decision to not pass the hike in domestic gas prices to the end-users have resulted in abrupted sales and will further worsen if the oil prices continue to decline

Quarterly performance trend



EBITDA for Q3FY15 grew negligibly due to lower top-line.

Net profit posted a growth of 20.9% YoY at ₹2,033.9 mn in Q3FY15 driven by a reduction in depreciation charges and higher other income.

Due to lower revenue, the EBITDA reported a marginal growth of 0.6% YoY and stood at ₹2,033.9 mn. Along with lower revenue the stagnation was also a result of higher than expected increase in the raw material costs per unit of the company. The PAT was reported at ₹1,082.0 mn marking a growth of 20.9% YoY. A sharp increase in the bottom-line was driven by lower depreciation (a decline of 33% YoY led by the Companies Act 2013 which increases the pipe network life from 10 to 25 years) and higher other income at ₹113.8 mn, an increase of 62.1% YoY.

We expect, IGL's CNG volume to be lackluster in the coming quarters with lower single digit growth led by feeble demand in the mandatory CNG user segment due to exit of certain route of buses in Delhi in FY13/14 and a delay in the rollout of incremental buses. Moreover its recent stance to cut the rates of CNG and PNG further could increase demand but will weigh down on realisations hence hurting margins in the short-term.

Short term woes sustain but long-term visibility remains favourable

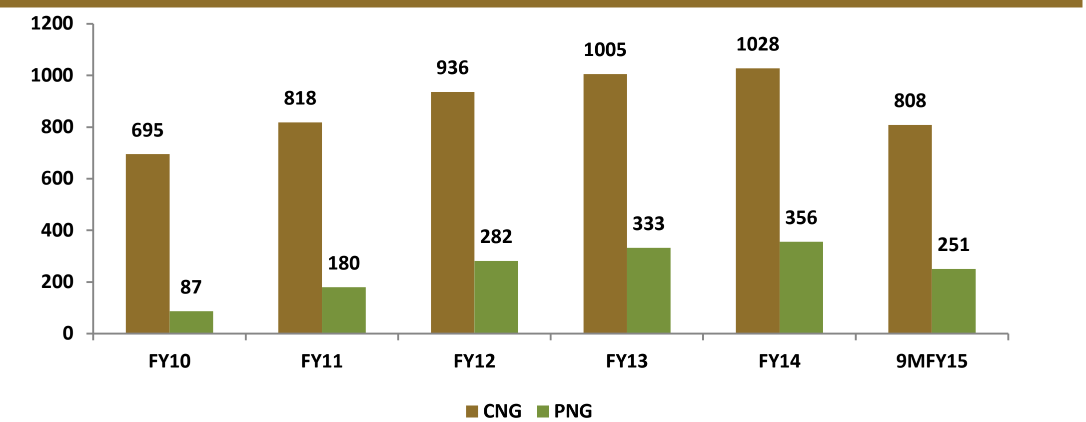
IGL's revenues are expected to grow with the increase in realization and huge demand of natural gas both in CNG and PNG segment due to pro-active emphasis of the government on infrastructure.

IGL's sales volume trend on an annualized basis has been on a steady rise since FY10. It has shown a collective increase in the PNG and CNG volumes growing from 789 mmscm in FY10 to 1384 mmscm in FY14. The volumes have shot up at a CAGR of 11.9% on account of government focus on CNG and PNG, expected rise in domestic gas production in medium to long term and lower current RLNG prices. At present, IGL supplies PNG to ~ 4.8 lakh households in Delhi and its adjoining areas in Noida and Ghaziabad while there are about 315 compressed natural gas (CNG) filling stations for automobiles.

Moreover, the Company is trying to enter into long term LNG supply agreement in order to reduce its dependence on higher spot cargoes. In this regard, IGL is in talks with its promoters GAIL & BPCL and others. Besides, the government has shown its strong purpose to increase the usage of gas to meet rising energy needs and to curb oil bills. There is also a noticeable focus on the associated infrastructure (gas pipeline/CGD) by the government.

The management has directed that apart from catering to the demand of households, the drive would be on tapping industrial and commercial customers who possess vast demand prospective. Also, private vehicles will continue to be a growth driver for CNG sales in the coming years. Delhi Transport Corporation (DTC) plans to add 1,400 CNG buses, which will provide an impetus to IGL's CNG business. In this regard, IGL has contracted a 10-year agreement with DTC to supply CNG till December 2020, which delivers sturdy visibility.

Sales volume trend (MMSCM)



CNG's price differential to aid volumes but upset revenue

In the coming years, the movement of the natural gas price will be key to the company's growth as the company is not passing on the hike in prices to the end users.

With the government's new directive of reducing the domestically produced PNG prices on March 31st 2015, the differential in PNG and alternative fuel narrowed. Nonetheless, IGL reduced the prices of compressed natural gas (CNG) and piped natural gas (PNG) in Delhi and the Uttar Pradesh towns of Noida, Greater Noida and Ghaziabad w.e.f April 1st 2015. The revision in prices would result in a decrease of ₹0.60 per kg in the consumer price of CNG in Delhi and ₹0.70 per kg in Noida, Greater Noida and Ghaziabad. The consumer price of PNG to the households in Delhi has been reduced by ₹0.60 per scm from ₹25.50 per scm to ₹24.90 per scm upto consumption of 36 scm in two months. This has broadened the price differential between CNG and other auto fuels such as petrol and diesel despite decline in oil prices enabling the company to increase volumes in the coming quarters. ***The medium to long term volume growth is optimistic commanded by steady CNG price outlook leading to greater private car conversion and city buses addition that is pending for tendering. Its recent stake purchases in other CGD entities would be worthy given the high growth in respective geographies.***

Strategic takeovers diversify revenue concentration thus providing triggers for growth limiting downside occurring from slow demand.

Strategic acquisition to translate into better sales

IGL recently bought a 50% stake in Pune's leading city gas distributor, Maharashtra Natural Gas (MNG) for ₹1,900 mn. This acquisition follows a 50% stake buy in Central UP Gas (CUG) last June for ₹700 mn. These two buyouts address a key concern of IGL - revenue concentration in the National Capital Region.

Being maturing entities, both MNG and CUG provide enormous growth prospect for IGL. Predominantly, these companies have strong balance sheets and can fund the capex internally. IGL has fairly aggressive expansion plans entailing an outlay of ~₹28,000 mn over FY13-FY 17. While the large scale of the capex, part of which will be debt funded, and the incubation period related with build-up of sales capacities, is projected to have some diminishing impact on the company's return and credit metrics from current levels, on an absolute basis, these metrics are expected to continue being robust.

IGL also plans to invest approx. ₹3,000 mn over the next five years in order to grow inorganically via the acquisition/JV route. ***The future progress plans of IGL are highly dependent on its ability to tie-up cost competitive new sources of gas and that its profitability margins going onward are estimated to experience a restraint in percentage terms due to rising gas costs though in absolute terms they would carry on to remain healthy. IGL continues to explore akin inorganic avenues in other cities, which could provide renewed triggers.***

Any unfavourable consequence in the PNGRB-IGL case will affect the margins negatively.

Statutory brawl continues to be an overhang

The downstream regulator Petroleum and Natural Gas Regulatory Board (PNGRB) has issued an order determining the transmission tariff and compression charges for IGL's city gas distribution (CGD) network in Delhi. As per the order, PNGRB has approved a significantly lower compression charge of ₹2.8/kg (vs. ₹6.7/kg as proposed by IGL) and network tariff of ₹38.6/mmBtu vs. ₹104.1/mmBtu as proposed by IGL retrospectively from April, 2008. Thus, the combined new tariff is around 60% lower than proposed by the IGL. Moreover, PNGRB has directed IGL to reduce its selling price for CNG and PNG in accordance with the lower transmission tariff and compression charges. The downstream regulator Petroleum and Natural Gas Regulatory Board (PNGRB) has issued an order determining the transmission tariff and compression charges for IGL's city gas distribution (CGD) network in Delhi. As per the order, PNGRB has approved a significantly lower compression charge of ₹2.8/kg (vs. ₹6.7/kg as proposed by IGL) and network tariff of ₹38.6/mmBtu vs. ₹104.1/mmBtu as proposed by IGL retrospectively from April, 2008. Henceforth, the combined new tariff is around 60% lower than proposed by the IGL. Moreover, PNGRB has directed IGL to reduce its selling price for CNG and PNG in accordance with the lower transmission tariff and compression charges.

Compression and Network Tariff

Category	Unit	IGL Tariff	PNGRB Tariff	% Reduction
Compression	₹/KG	6.66	2.75	41.29
	₹/scm	5.35	2.21	41.31
Network	₹/mmBtu	104.05	38.58	37.08
	₹/scm	3.75	1.39	37.07

Balance Sheet (Consolidated)

(₹mn)	FY14A	FY15E	FY16E	FY17E
Share Capital	1,400.0	1,400.0	1,400.0	1,400.0
Reserve and surplus	16,231.6	20,178.4	24,489.4	28,742.0
Net Worth	**17,631.6**	**21,578.4**	**25,889.4**	**30,142.0**
Long-term borrowings	2,875.1	4,275.1	4,275.1	4,275.1
Deferred tax Liability	962.7	1,095.5	1,095.5	1,095.5
Provisions	81.3	81.3	95.9	113.2
Current Liabilities	6,969.4	6,374.0	6,510.3	6,650.7
Capital Employed	**28,520.1**	**33,404.3**	**37,866.2**	**42,276.5**
Fixed assets	21,575.9	21,537.2	21,967.9	22,407.3
Long term loans & advances	109.7	109.7	109.7	109.7
Non-current Investments	691.7	2,591.7	2,591.7	2,591.7
Current Assets	6,142.8	9,165.7	13,196.8	17,167.8
Capital Deployed	**28,520.1**	**33,404.3**	**37,866.2**	**42,276.5**

Profit & Loss Account (Consolidated)

(₹mn)	FY14A	FY15E	FY16E	FY17E
Total Income	39,221.6	40,035.2	40,875.9	41,734.3
Operating Expenses	31,397.7	31,227.4	31,474.4	32,135.4
EBITDA	**7,823.9**	**8,807.7**	**9,401.5**	**9,598.9**
Other Income	210.8	326.4	326.4	326.4
Depreciation	2,195.4	1,475.8	1,515.8	1,546.1
EBIT	**5,839.3**	**7,658.3**	**8,212.1**	**8,379.2**
Interest	441.3	390.4	398.2	406.2
PBT	**5,398.0**	**7,267.9**	**7,813.9**	**7,973.0**
Tax	1,795.4	2,420.2	2,602.0	2,654.7
Net Profit	**3,602.6**	**4,847.7**	**5,211.8**	**5,318.3**

Key Ratios (Consolidated)

	FY14A	FY15E	FY16E	FY17E
EBITDA Margin (%)	19.9	22.0	23.0	23.0
EBIT Margin (%)	14.9	19.1	20.1	20.1
NPM (%)	9.2	12.1	12.8	12.7
ROCE (%)	27.1	28.3	26.2	23.5
ROE (%)	20.4	22.5	20.1	17.6
EPS (₹)	25.7	34.6	37.2	38.0
P/E (x)	16.4	12.2	11.3	11.1
BVPS (₹)	125.9	154.1	184.9	215.3
P/BVPS (x)	3.3	2.7	2.3	2.0
EV/Operating Income (x)	7.4	6.8	6.1	5.7
EV/EBITDA (x)	7.6	7.1	6.3	5.9

Valuation and view

Currently, IGL stock banks upon positive volume growth catalysed by swelling auto demand, likely increase in the quantity of DTC buses in NCR and the takeover of Maharashtra Natural Gas Ltd. Going further, the company’s tactical extension plans will aid it in differentiating its revenue and thus improving margins over the years. We remain hopeful on the Supreme Court’s awaited ruling on the PNGRB brawl as the apex court is working out a compromise formula.

At the CMP of ₹422.0, the stock trades at P/E of ~11.0x FY16E. We recommend ‘BUY’ for this stock considering the aforementioned aspects with a target price of ₹521.0 placing a P/E multiple of 14x for FY16E, which implies potential upside of ~24% to the CMP from 1 year perspective.

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