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Investors with a one-to-two-year investment horizon can consider accumulating, on dips, the stock of city gas distribution company Indraprastha Gas Limited. Indraprastha Gas, promoted by GAIL and Bharat Petroleum Corporation Limited, is into distribution of city gas — piped natural gas (PNG), compressed natural gas, CNG (auto fuel and industrial gas supplies). The company, which is a dominant player in the New Capital Region, has been scaling up presence in other markets too, which will support growth in the near to medium term.

Also, the resolve of the Government to increase share of natural gas in the country's overall energy consumption, from about 7 per cent now to 15 per cent by 2030, augurs well for gas producers and distribution companies.

The stock currently trades at 17 times its trailing twelve-month earnings. Since 2016, the stock has traded at a median multiple of 28 times its trailing earnings, implying a potential 61 per cent premium to the current valuation.

Indraprastha Gas' business comprises CNG — which is basically used as auto fuel, and Piped Natural Gas (PNG) which is supplied to household and industrial units. Of this, CNG constitutes about 75 per cent of the gas sales in volume terms for the company. Of the balance, 13 per cent of the total gas volume is supplied to industrial units as piped natural gas, 6 per cent each to residential complexes (PNG) and other city gas distributors (who, in turn, sell to end-users).

We believe the company to be a good diversification bet for investors for four reasons.

First, the company is a dominant player in the Northern market, with focus on Delhi, National Capital Region — Noida and Greater Noida, Ghaziabad and is also present in other markets such as Rewari, Karnal, Kaithal, Kanpur, Muzaffarnagar and Ajmer. As of September 2023, it had 725 CNG fuelling stations. On the PNG segment, the company caters to 21.7 lakh residential units and 8,200 industrial customers, as of September 2023.

The company is also expanding presence in other markets such as Gurugram (Haryana), Banda and

More steam left as growth plays out

OIL AND GAS. Indraprastha Gas is a good diversification bet



Mahoba (Uttar Pradesh) and Chitrakoot (Madhya Pradesh). It is spending ₹1,200 crore in 2022-23 as capex for expansions in newer areas that have been allocated to the company and will also be commissioning 75 to 100 CNG stations in FY23.

Second, the Government, in August 2022, increased allocation of cheaper Administered pricing mechanism (APM) gas to city gas distribution (CGD), in order to keep CNG and PNG prices under check. City gas distribution companies such as Indraprastha Gas were losing out on their margins due to high cost of imported and non-APM gas on one side and inability to pass on input cost price increases to customers (PNG and CNG).

To provide relief to CGD companies, the increase in allocation to 20.74 mmcmd caters to almost 94 per cent of the total CGD requirement. This has increased from 85 per cent in Q1FY23. With this move, higher availability of subsidised gas should ease the pressure on margins for Indraprastha Gas. Also, easing spot LNG prices over the last few months will further help reduce the input costs and result in margin expansion. Spot LNG prices have more than halved to about \$28 per mmbtu compared to peak

price of over \$70, due to higher-than-expected gas inventory in Europe and expectation of modest demand.

Third, gas demand in India continues to remain strong, even as LNG prices hit the roof in early FY23. Except for the power sector, which has seen lower gas offtake due to high prices, the demand from industrial users has remained strong. CNG demand continues to grow at an impressive double-digit rate.

The removal of Covid restrictions has helped the strong growth in CNG demand, which stood at 6.01 mmcmd in 1HFY23, which is more than the 5.06 mmcmd for FY22. Commercial demand during 1HFY23 grew to 0.18 mmcmd from 0.14 mmcmd in FY22. Overall, per day sale volume in 1HFY23 has already surpassed FY22 at 7.99 mmcmd, compared to 6.99 mmcmd in FY22. The total gas volume in 1HFY23 stood at 1462 mmcmd, compared to 2551 mmcmd in FY22. We expect the strong growth in gas to continue in the near future.

Four, strong balance sheet with negligible debt of ₹99 crore as of September 2022, favourable cash conversion cycle (negative of 37 days in March 2022) adds to the attractiveness of the business

● ACCUMULATE
Indraprastha Gas
₹416.50

WHY

- Geographical expansion will drive growth
- Healthy demand to continue
- Strong balance sheet

The lower profit growth was on account of higher LNG prices and inability to pass on the increases fully to customers. However, now, with higher APM allocation and fall in LNG prices, operating margins should improve in the near term. The stock currently trades at a reasonable 17 times its trailing twelve-month earnings, compared to its median valuation of 28 times, historically. Investors can use any correction in the stock price as an opportunity to build position in the counter.

RISKS

The Delhi government, which runs the largest CNG bus fleet, has announced plans to switch to EV buses over the next few years and will commence the process to add about 100 EV buses soon. The total fleet currently stands at 7,140 buses and the Government is rolling out 2000 CNG buses this year. While this may pose a risk to long-term growth prospects for CNG companies, the complete transition from CNG to EV will take longer, given the challenges such as high cost of EV technology — EV bus is almost 3 times that of a CNG bus. Thus we do not foresee any major risk in business for Indraprastha in the next 1-2 years. However, this space requires to be watched

from an investment perspective. The company has historically enjoyed impressive return on capital employed in excess of 30 per cent. In FY21, despite the adverse Covid impact, Indraprastha Gas has managed to maintain ROCE of 24 per cent, which improved to 27 per cent in FY22 and is expected to go past the 30 per cent mark in FY23.

In the 1HFY23, the company reported revenue of ₹6,748 crore, which is a growth of 118 per cent compared to the same period last year. Operating profit stood at ₹1,146 crore, higher by 26 per cent year-on-year. Net profit grew by 30 per cent to ₹908 crore in April-September 2022 period, compared to the same period last year.