AJCON GLOBAL

YOUR FRIENDLY FINANCIAL ADVISOR

Investor's Delight – Indraprastha Gas, GAIL, ONGC **Feb.18, 2019**

View on equity markets and top picks..

A deadly attack against security forces in Pulwama in Jammu and Kashmir on Thursday last week shocked the nation and weighed on investor sentiments as the security forces have been given a free hand to punish the perpetrators of the attack.

The outcome of Lok Sabha elections in May, however, is seen as the biggest local event that will set a direction for markets. Until then, equity gauges are expected to react to progress on global developments such as Brexit and U.S.-China trade talks.

Foreign portfolio investors have pumped in a net of US$767.77 million into Indian equities so far in February.

Oil prices rose more than 2 percent to their highest this year on February 15 after an outage at Saudi Arabia's offshore oilfield boosted expectations for tightening supply, while progressing US-Sino trade talks strengthened demand sentiment. The international Brent crude benchmark rose US$1.68, or 2.6 percent, to settle at US$66.25 a barrel, its highest since November. U.S. West Texas Intermediate crude futures settled up US$1.18, or 2.2 percent, at US$55.59 a barrel, and hit their highest this year in post-settlement trade at US$55.80.

All eyes would be now on global cues and domestic cues amidst deadly terror attack against security forces. We deeply mourn the sacrifices of our brave soldiers, their memory will remain in our hearts. Globally, all eyes would be on ongoing tussle between US and China. The recent slowdown in China's economic growth is also a cause of concern for global investors. Growing confidence that the United States and China will resolve their ongoing trade dispute will help boost global investor sentiments. Those talks will restart next week in Washington, with both sides saying this week's negotiations in Beijing showed progress. Clarity on Brexit would also act as a key trigger for investor interest.
Investors have turned cautious ahead of the forthcoming general elections. Investors sentiments were dampened by the steep decline in shares of certain largecap and midcap companies amidst mixed earnings performance in Q3FY19. All the sectoral indices lost value over last seven sessions. Metals and oil sectors were beaten the most, with BSE Metals index eroding 5.82 per cent in seven sessions, while BSE oil & gas index erased 5.76 per cent and BSE Auto index 5.20 per cent. The equity markets have turned very volatile and even Companies with a massive scale are not spared. The recent volatility in stock prices of Tata Motors, Dr. Reddy's, Sun Pharma, Yes Bank, Vedanta, Essel group companies, Anil Ambani group companies is a matter of concern as retail investors are getting trapped with every newsflow. As a result, we advise investors to be cautious on the newsflow in markets, do proper analysis and neither rush to take fresh positions or square off the existing positions or holdings on disturbing newsflows unless getting a proper clarity of a particular event or on Company's performance.

We believe domestic bourses would remain volatile till general elections 2019 results are out. There would be temporary headwinds for investors but on a long term perspective we believe the Indian equity markets are in a structural bull run as the benefits of implementation of GST, Insolvency and Bankruptcy code, digitization, thrust on Make in India and improving relations with key foreign countries would augur well for the economy in the long run. The strategy at present should be to invest in phased manner only in companies which are not connected to any political party, have a robust business model, strong earnings and cashflow visibility, low debt and backed by quality management especially on the corporate governance front. Considering the above factors, investors can have a stock specific approach in midcaps and smallcaps space as there are many companies which are trading at a discount of 50-70% to their peak price in early 2018. On a safer side, we would suggest investors to have a look at Consumption stocks, top quality Pharma companies, NBFCs having strong parentage, Auto and auto ancillary stocks, Gas companies, PSU banks (looking better after the cleanup of NPA mess, progress made under IBC), IT sector and Private Insurance Companies at the current moment.

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Top picks

1) Indraprastha Gas Ltd. (IGL)

CMP: Rs. 282, Face value: Rs. 2, Target price: Rs. 350, Upside: 24%

Price chart source: Moneycontrol

Investment Rationale

We like Indraprastha Gas Ltd. as it is a structurally strong story on CNG distribution. Initiative to substitute crude oil with natural gas to reduce India's import bill also has the potential to give a boost for extensive gas usage. In this backdrop, we are of the view that the anticipated increase in gas demand would come mainly from retail segment or from the city gas distribution sector. Besides World Health Organization report of May 2018 also mentions that majority of the most polluted cities in the world are from India. If this situation is to be reversed and getting a cleaner and healthy environment for our citizen becomes a basic priority and if India is to fulfill its COP21 commitment to reduce the emission intensity of its GDP then there has to be larger penetration of natural gas in Indian energy basket.

Incorporated in 1998, IGL is a Joint Venture of GAIL and BPCL. Govt. of NCT of Delhi is also holding 5% equity. IGL started its operations in NCT of Delhi in 1999 with only 9 CNG stations and 1,000 PNG consumers. Today, IGL has its operations in NCT of Delhi, Noida, Greater Noida, Ghaziabad and Rewari with 463 CNG stations,10.29 lacs residential consumers and ~4100industrial/commercial customers. The Company is fuelling the largest CNG Bus fleet in the world.

The Company boasts of strong consistent financial performance in last few quarters and even Q3FY19 results displayed strength with volume growth of 12.2 percent and realization growth of 13.6 percent. The management expects to win around 3-4 geographical areas (GA) in the latest city gas distribution (CGD) bidding round where the Company has bid for 15 GA. Owing to the expectation of wionning -3-4 GA, the Company envisages a capex of around Rs 3,000-5,000 crore, which is expected to be funded through internal accruals. The management remains positive of achieving double-digit volume growth even in upcoming quarters. The Company's expansion in Gurugram, Meerut, Muzaffarnagar and Shamli is expected to drive volume growth. Rewari and Karnal are expected to drive incremental industrial

volumes. IGL has started sale of CNG at four OMCs outletsin Rewari and sale of PNG to Domestic households. IGL plans to add ~6 more CNG outlets and to connect 1500 Domestic households in FY19.

Supply of gas has been started in areas of Bawal and Dharuhera. IGL has recently got entry into Gurgaon to lay inf rastructure; initially thepermission has been given for the area between westside of SohnaRoad and NH8 in Gurugr am district.

There are temporary headwinds like margin pressure owing to increase in operating costs and margins to OMCs. In an interview to media, ES Ranganathan, managing director, said IGL always maintained double-digit growth and this year also the company may record 11percent. Ranganathan said, "US dollar has stabilised now. It was volatile before and since administrative price mechanism (APM) and liquefied natural gas (LNG) price are set at the dollar, so the exchange rate will also play a big part on the pricing." Although the stock has rallied, we still find value in the Company as it is a structurally strong Company operating in sunrise sector with impeccable execution record with zero debt. At CMP of Rs. 282 (Face value: Rs. 2), the stock trades at a P/E of 29x on FY18 EPS of Rs. 9.58. 9M FY19 EPS stood at Rs. 8.02. We recommend a “BUY” with a target price of Rs. 350 (25x on FY20 estimated EPS of Rs. 14) implying an upside of 24 percent for investors with a horizon of 12 months.

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2) GAIL India Ltd. (GAIL)

CMP: Rs. 317, Face value: Rs. 10, Target price: Rs. 390, Upside: 23%

Price chart source: Moneycontrol

Investment Rationale

The Company is creating value across the entire gas Value Chain – Natural Gas (Around 11,000 km of pipeline network an expanding to 15,000 km), Liquid Hydrocarbons (7 Gas processing units producing LPG, Propane, Pentane, Naptha etc. LPG Transport Capacity - 3.8 MMTPA (2,038 km), Petrochemicals (domestic market share of around 20 percent), exploration and production (participation in 15 blocks with presence in Myanmar and US), City gas distribution (serving over 1.4 million vehicles & 1.4 million households through Subsidiary and Joint ventures. The Company has signed long term LNG supply contracts for 3.5 MMTPA with Sabine Pass Liquefaction LLC, USA, 2.3 MMTPA with Dominion Cove Point LNG, USA and 2.5 MMTPA with Gazprom Shtokman LNG project, the supplies from which have commenced from 2018 upto 2020. GAIL has signed around 30 Master Sales Purchase Agreements with all reputed LNG suppliers including BG, SHELL, Total, etc. under which it has been importing LNG cargoes from time to time. In addition, GAIL is importing LNG under term deals signed from time to time with various suppliers.

The Company witnessed decent Q3FY19 result due to higher revenue from its natural gas marketing and liquefied petroleum gas business. In Q3FY19, the Company witnessed 33 percent growth on yoy basis (PAT) to Rs. 1,681 crores was supported by increase in Natural Gas Marketing volumes by 9%, LPG Transmission volumes by 11% and Liquid Hydrocarbon Sales by 5%. On nine months basis, GAIL's PAT is Rs. 4,903 crore, signifying an increase by 36% against corresponding period of FY 2017-18. bShri B C Tripathi, Chairman & Managing Director, GAIL said that in the third quarter, the LHC Segments performed remarkably better than the last quarter due to better margin in the segment. However the margins in Natural Gas Trading and Petrochemical segments were under pressure in the quarter. Further on nine month basis, the PAT of the Company has already surpassed the yearly PAT of the last fiscal supported by better physical performance in all the business segments. The Company management also indicated that GAIL's petrochemical unit at Patna has scripted history by being the first in India to produce the value added Metellocene film grade. Country-wide sales have commenced to quality conscious customers after successful field trials. This move of GAIL would not just provide domestic consumers of a reliable and indigenous supply source but shall help potential forex savings of over USD 100 million annually for India, as per initial estimates. He said GAIL is expected to achieve Capital expenditure outlay of around Rs. 7,000 crore during 2018-19 which is more than 70% increase from last year. The first phase of prestigious Pradhan Mantri Urja Ganga project will be completed by the end of this month.

At CMP of Rs. 317, the stock trades at a P/E of 16x on FY18 EPS of Rs. 20.48. We recommend a "BUY" with a target price of Rs. 420 (15x at estimated FY20 EPS of Rs. 28) for investors with a horizon of 9-12 months.

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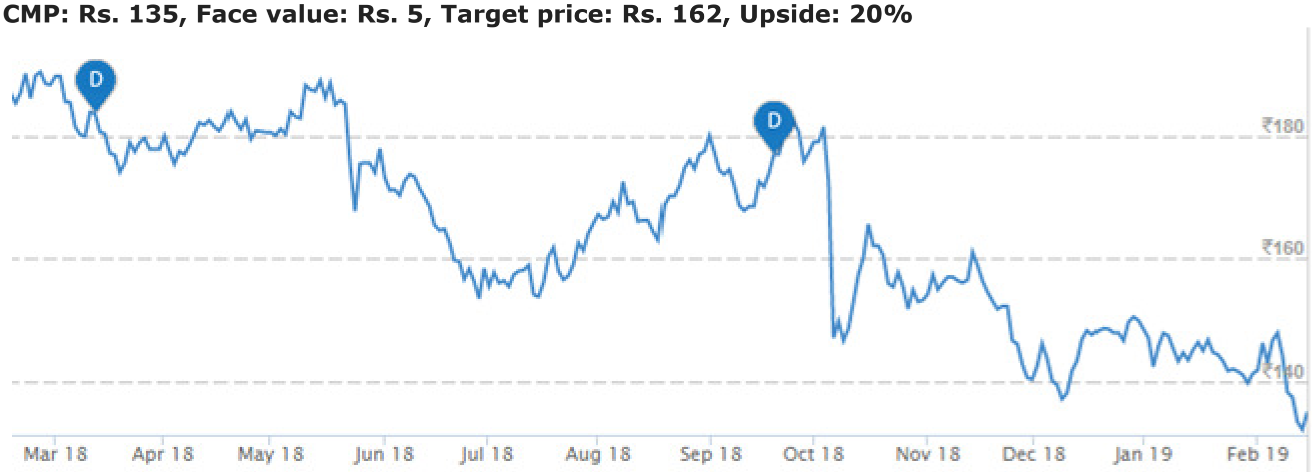
3) **Oil and Natural Gas Corporation Ltd. (ONGC)**

CMP: Rs. 135, Face value: Rs. 5, Target price: Rs. 162, Upside: 20%



Price chart source: Moneycontrol

Investment Rationale

The Company's Q3FY19 results were above our expectations. Gross Revenue was up by 20.4 percent on qoq basis to Rs. 27,694 crore.

Net Profit witnessed a growth of 64.8 percent on qoq basis to Rs. 8,263 crores. The company's written-off cost for exploratory witnessed a rise of 79% on yoy basis and 120% sequentially to Rs. 2,388.42cr during the quarter.

The company got US$ 66.38 for every barrel of crude oil it sold in the quarter, 13.6 per cent higher than US$ 58.42 per barrel realisation a year ago. Gas prices were 163 per cent higher at US$ 3.36 per million British thermal unit. ONGC said crude oil production dropped 4.8 per cent to 6.03 million tonne but gas output rose 6.6 per cent to 6.7 billion cubic metre. During first nine months of this fiscal, oil production dipped 4.7 per cent to 18.33 million tonne, while gas output was up 4 per cent at 19.25 billion cubic metres.

In terms of exploratory performance, two new basins i.e. Vindhyan and West Bengal have been upgraded to Category II during the current financial year. The appraisal plans are drawn to further upgrade them as producing basins. ONGC has notified total 11 discoveries so far in FY'19 (4 discoveries after last press release on 03.11.2018). Gas was found in a well drilled in block GK-OSN-2009/1 in Kutch offhsore, while a new gas prospect was discovered in block VN-ONN-2009/3 in Vindhyan basin in Madhya Pradesh. Another exploratory well stuck gas in Golaghat block in Assam, while oil flowed from a well drilled in western offshore basin.

Standalone Natural Gas Production was up 7% on qoq basis and VAP Production up by 3.3% on qoq basis.

ONGC Chairman and Managing Director Shashi Shanker, earlier indicated that the vision document 'Strategic Roadmap 2040' would craft the strategy for the firm as an integrated energy major with a long-term perspective. "Our portfolio has seen a metamorphic change in the last decade. Today our business portfolio includes E&P, refining, petrochemicals, LNG, pipelines, retail, SEZ Infrastructure, power etc. While these developments open up new vistas and opportunities for the company, they also add layers of complexity to our decision-making and strategic framework," he said. Shanker said ONGC is considering many opportunities for sustaining growth and fulfilling its vision of becoming a global energy leader. The exercise also envisages evaluating potential growth areas, both within and outside India, so that ONGC is able to prioritise suitable actions well in advance.

At CMP of Rs. 135, the stock trades at a P/E of 9x at FY18 EPS of Rs. 15.54 and at a P/E of 6x at annualized 9MFY19 EPS of Rs. 23.56. We recommend a "Buy" with a target price of Rs. 162 (6x at estimated FY20 EPS of Rs. 26)

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Buy – Absolute return of 20% and above
Accumulate – Absolute return between 15% and above
Book profits: On achieving the price target given in the research report for a particular Company or on a occurrence of a specific event leading to change in fundamentals of the Company recommended

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