Morning Insight

SEPTEMBER 7, 2018

	6-Sep	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	38,243	0.6	1.5	8.7
NIFTY Index	11,537	0.5	1.3	8.0
NSEBANK Index	27,469	0.3	(1.5)	4.2
NIFTY 500 Index	9,815	0.5	1.1	6.6
CNXMcap Index	19,327	0.4	0.7	4.7
BSESMCAP Index	16,804	0.5	(0.6)	2.0
World Indices				
Dow Jones	25,996	0.1	1.4	3.0
Nasdaq	7,923	(0.9)	0.5	3.8
FTSE	7,319	(0.9)	(5.2)	(5.0)
NIKKEI	22,488	(0.4)	(1.8)	(2.4)
Hangseng	22,488	(0.4)	(1.8)	(2.4)
Shanghai	26,975	(1.0)	(4.7)	(14.6)

Value traded (Rs cr)	6-Sep	% Chg Day
Cash BSE	2,694	(23.6)
Cash NSE	34,986	(5.6)
Derivatives	2,187,007	61.1

Net inflows (Rs cr)	5-Sep	MTD	YTD
FII	(315)	2,740	(2,699)
Mutual Fund	151	436	77,053

Nifty Gainers & Losers 6-Sep	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Reliance Ind	1,261	2.8	11.2
Cipla	662	2.4	2.8
Coal India	284	2.2	3.0
Losers			
Zee Entertainment	470	(2.5)	17.9
Hindalco Ind	235	(1.9)	7.4
Maruti Suzuki	8,760	(1.5)	0.7

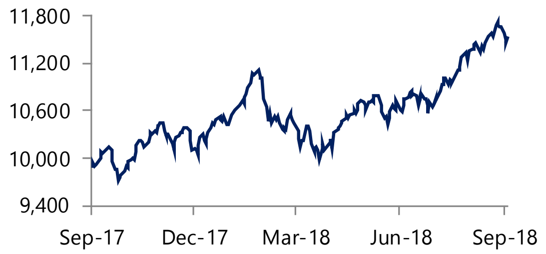
Advances / Declines (BSE)

6-Sep	A	B	T	Total	% total
Advances	253	636	74	963	100
Declines	176	374	67	617	64
Unchanged	3	24	17	44	5

Commodity	6-Sep	% Chg 1 Day	1 Mth	3 Mths
Crude (US$/BBL)	76.5	(0.1)	2.4	(1.1)
Gold (US$/OZ)	1,200	0.3	(0.7)	(7.3)
Silver (US$/OZ)	14.2	(0.2)	(7.8)	(15.1)

Debt / forex market	6-Sep	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.1	8.1	7.8	7.9
Re/US$	72.0	71.8	68.9	66.9

Nifty



Source: Bloomberg

News Highlights

- US will consider waivers for Iranian oil buyers such as India. Some sanctions came in effect on 6 August and the rest, including in the petroleum sector, will take hold on 4 November. (ET)
- India, U.S. yesterday signed Critical Defence Pact under which critical and encrypted defence technologies will be provided to the Indian military by the U.S. (ET)
- The ministry of road transport and highways has formulated a list of non-fiscal incentives to ensure that electric vehicles (EVs) account for 15% of total vehicle sales in the next five years. (Mint)
- The U.S. drug regulator issued **Sun Pharmaceutical Industries Ltd.** six observations to its Halol plant for inspections done during Aug. 27-31. (Mint)
- **Escorts Ltd** had launched an automated concept tractor, designed for precision farming. The prototype driverless tractor, which the company also calls a smart tractor, is able to automate operations like ploughing and seeding. (Mint)
- **L&T Technology Services** to acquire 100 percent stake in in Graphene Semiconductor Services Pvt Ltd. for Rs 930 million. (ET)
- **Welspun Corp** has entered an agreement for supply of 220 KMT of Pipes for Oil & Gas project in the Americas region. With this addition, company's current order book stands at 1,776 KMTs valued at Rs 150 bn. (BS)
- **IDBI Bank Ltd** has approached the dedicated bankruptcy court against Reliance Naval and Engineering Ltd for defaulting on loans totaling more than Rs 12.5 bn. (BS)
- **Bajaj Auto** will enhance its production capacities of three-wheeler and quadricycles to one million per year. (ET)
- **L&T Financial Services** clarified that it had submitted necessary details to the Registrar of Companies regarding its IPO in July 2011 and has still not received any further communication. (ET)
- **Gufic Biosciences** received NCLT nod for merging Gufic Stridden Bio-Pharma Private Limited with self.(BL)
- With **Jet Airways** delaying salaries of its pilots and engineers for the second consecutive month amid a severe financial crunch, its pilots have warned the management of "non-cooperation". (BS)
- **Amara Raja Batteries Ltd** will build a lithium-ion assembly plant as it seeks to grab a slice of the market for electric vehicle power packs that is set to grow to $300 billion by 2030. (BL)

What's Inside

- **Sector Update:** Steel
- **Company Update:** Indraprastha Gas

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Sector Update

Metal Prices

	Aug-18	Jul-18	MoM%
(US$/T)			
Iron ore fines 63.5% Fe	67.1	64.6	3.9
Pellet	137.0	110.0	24.5
Rott Shredded Scrap	350.8	366.3	(4.2)
China Spot HRC	633.4	643.0	(1.5)
China Spot CRC	704.7	710.9	(0.9)
Domestic Prices (Rs/T)			
Pellet	8,500	7,200	18.1
Sponge Iron	23,650	22,663	4.4
Rebar	38,000	37,150	2.3
HRC	45,375	45,250	0.3
CRC	50,000	50,063	(0.1)

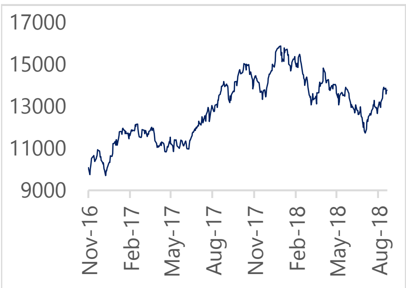
Source: Bloomberg & Industry data

Comparison

	1M	3M	6M	1Y
Sensex	1.5	7.8	15.8	12.3
Nifty	1.3	7.1	13.6	9.6
BSE Metal	5.4	(1.0)	(3.9)	(7.8)
Tata Steel	4.7	(0.3)	(7.3)	(13.0)
JSW Steel	17.1	16.1	37.8	47.8
Jindal Steel & Power	(1.3)	(13.4)	(8.6)	3.3
SAIL	(3.9)	(7.5)	3.9	(16.9)
Tata Sponge	4.0	(13.8)	(7.1)	(4.9)
Sarda Energy & Min	(4.1)	(2.2)	(7.7)	(19.2)
Godawari Power	12.9	34.9	20.0	53.5
Prakash Industries	(4.6)	(11.7)	(13.5)	(24.1)

Source: Bloomberg

BSE Metal Index



Source: Bloomberg

STEEL SECTOR

Production cuts in China, have helped steel prices (including semi-finished products) to sustain even in the lean monsoon season and it also describes the country's stringent regulations to curb the overall pollution. Production cut during the last winter led to a ~5% YoY decline in the steel production. The cuts in 2018 have further extended and upcoming winter cuts are spread across six provinces (Hebei, Shandong, Tianjin, Jiangsu, Shanxi and Shaanxi provinces) and will cover ~50% of the country's steel production (crude steel and finished steel). This has resulted in increased demand of high grade ore (pellets) prior to production cut, which led to ~28% YoY rise in pellet prices to Rs9,100/tonne (~4 years high). The rise in pellet prices are also supported by closure of Samarco's mine and Force Majeure at LKAB. Both these factors led to an uptick in export demand for pellet from India.

Key Highlights

- China has extended the duration of production cuts for its steel industry during the winter by two months starting from Oct 1 till Mar 31 next year in 28 cities. This compares to the last year period from Nov 15 till until Mar 15 this year.
- Crude steel output in the five months of winter production cuts between Nov 2017 and Mar 2018 fell to 137MT from 144MT last year, as per country's National Bureau of Statistics.
- Accelerated crude steel production and declining finished steel inventory has led to a sharp surge in the raw material and steel intermediary prices like pellets, sponge iron and billets, but the same momentum was not seen in finished steel prices.
- We believe that prices of intermediaries will correct in the near future, but likely to remain high compared to the average of 1QFY19.

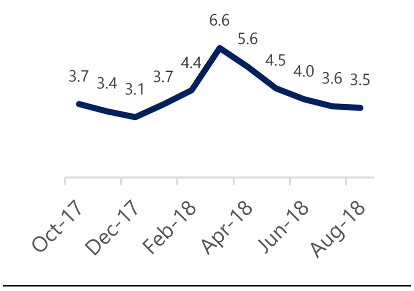
Outlook

Increasing demand from China for high quality ore (pellet), has led to shift in focus of Indian pellet manufacturer to the export market, thereby creating paucity in the domestic market, resulting in a sharp search in pellet price to Rs.9100/tonne, at four years high. Increased margin in pellet has supported the domestic miners to raise the iron ore prices in the last fortnight. Due to cost inflation, sponge iron and billet prices have also witnessed a sharp surge in the last one month. The uptick in the billet prices was also supported by falling inventory (down 10% YoY) and the spreads between intermediate and HRC are at the highest level YTD. We believe that the benefit of the higher prices will be seen from 3QFY19 onwards. We expect integrated steel makers to emerge as key beneficiaries in this scenario.

Demand for high grade ore increased, prior to production cut

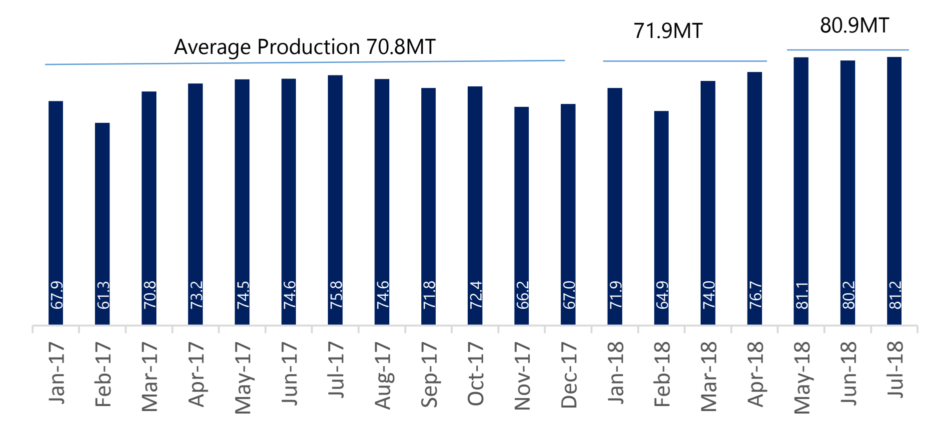
China average monthly steel production stood at 80.9MT in the last three months (May-Jul), higher by ~5MT, compared to the average of YTDCY18 and ~10MT higher than CY17. We believe that, the recent pick up in the production activity was supported by fall in finished steel inventories and strong demand from the construction sector. This has supported the demand for high grade ore (which was in line with stringent policy to curb pollution).

China warehouse steel inventory (MT)



Source: Bloomberg, Kotak Securities – Private Client Research

China Monthly Steel production (MT)

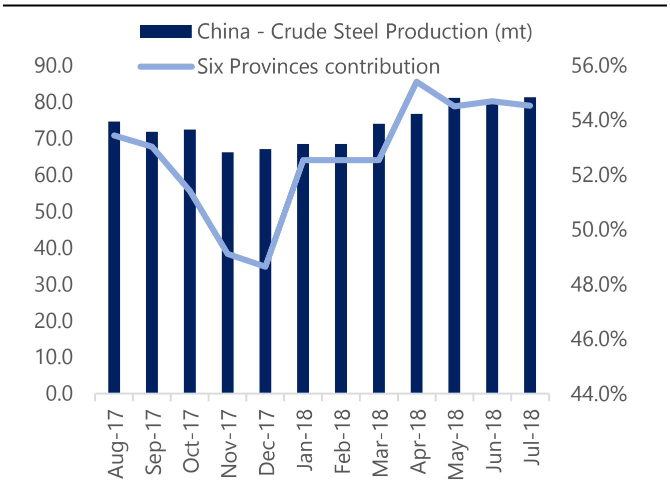


Source: WorldSteel.org, Kotak Securities – Private Client Research

Production cuts extended to additional 3 provinces

China has extended its stringent policies to additional 3 provinces, i) Jiangsu, Chinese authorities are contemplating reducing output by 50% throughout in November, advancing the winter cut by 15 days as the International Import Expo (CIIE) will be held in Shanghai from November 5-10; ii) Tanghan, steel mills are likely to face production cuts of at least 50% from September 1. Also, the Tangshan government raised cuts on mills in Fengnan and Guye districts to 50% (30% earlier) As per the media reports all blast furnaces in the regions, including urban areas of Fengnan and Fengrun, have been running at 50% of capacity since August 10 and iii) Shandong, the local government initiated a fresh round of environmental probes. In all, winter production cut has been extended to six provinces, which contribute around 50-55% of the country's total crude steel production and finished steel production.

Contribution to crude steel production



Source: Bloomberg, Kotak Securities – Private Client Research

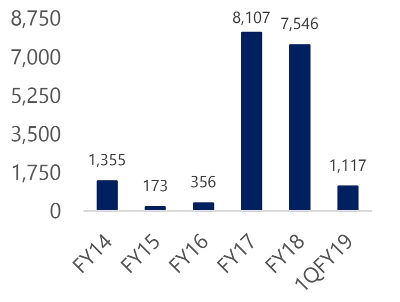
Contribution to finished steel production

Source: Bloomberg, Kotak Securities – Private Client Research

Pellet prices likely to sustain in the near term, but h*igh possibility of coming down*

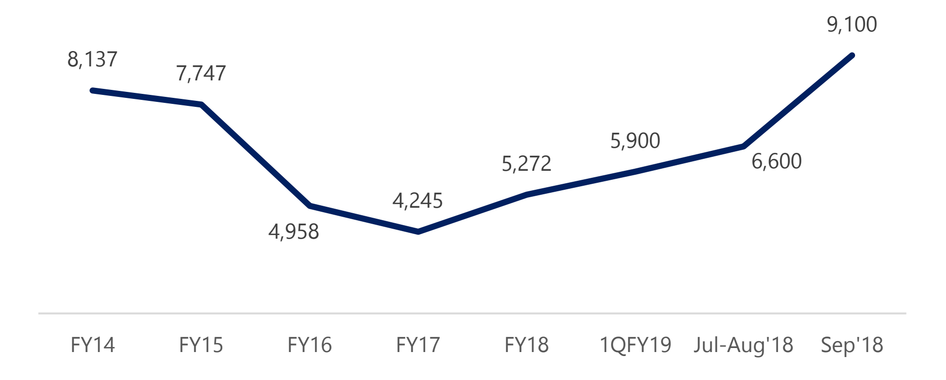
On the back of huge demand for high grade ore (pellets) from China (to curb pollution) and closure of Samarco's mine and Force Majeure at LKAB, pellet prices have surged sharply in the last one month. Strong demand from export markets (particularly China as steel mills have started cutting down imports of iron fines with high alumina content) resulted in Indian pellet export (FoB) prices touching US$138/tonne, up ~40% compared to 1QFY19. In FY18, China's share in total pellet export from India stood ~80%. The average prices during Jul-Aug'18 were Rs650-700/tonne higher, compared to average of ~Rs5,900/tonne in 1QFY19 and the current price of pellets are ~Rs9,100/tonne (4 years high). We believe that, prices are likely to sustain in the month of September as well. However, we foresee prices correcting, once production cuts are taken (starting October). Besides this, pellet capacity additions by Chinese steelmakers would also weigh on the prices in the medium to long term. However, we believe the problem in China is structural in nature and demand for high grade ore (pellet) would sustain, as steel mills in China have shifted their preference to high grade ore. As a result, we believe, pellet prices are likely to remain higher than the average of Jul-Aug'18 in the near term.

India export of pellets to China ('000 T)



Source: Industry Data

Pellet prices to sustain for the month of September also

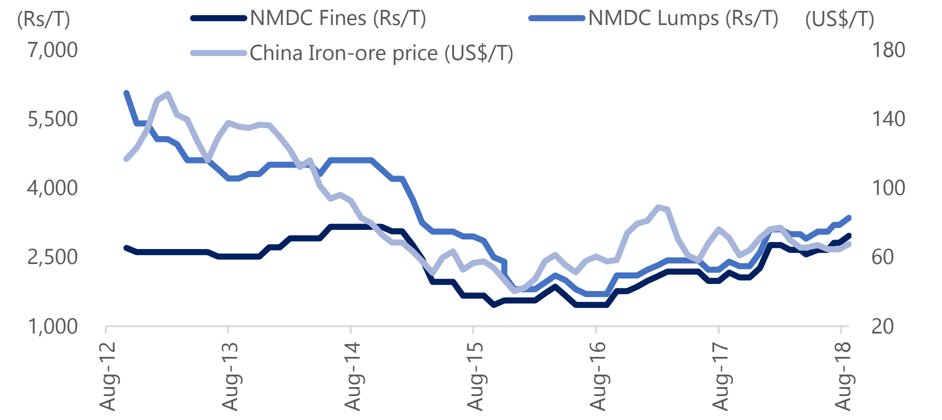


Source: Industry data, Kotak Securities – Private Client Research

Strong pellet demand led to uptick in iron ore prices

The recent hike in the iron ore prices is backed by rupee depreciation, a 4% increase in international iron ore prices compared to the previous month and the surge in pellet prices (~4 years high). We believe that, the uptick in iron ore prices coupled with strong uptrend in sponge iron prices (Rs25,000-Rs26,000/tonne), resulted in increase in rebar prices (Rs38,000-Rs39,000/tonne), to maintain margins.

NMDC's iron ore prices vs global prices

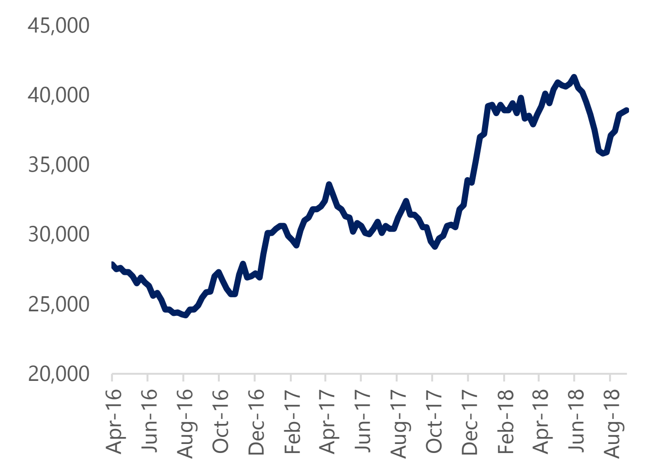


Source: Company, Bloomberg, Kotak Securities – Private Client Research

Sponge iron prices trend (Rs/T)

Source: Industry data, Kotak Securities – Private Client Research

Rebar prices trend (Rs/T)



Source: Industry data, Kotak Securities – Private Client Research

Company Update

INDRAPRASTHA GAS LTD (IGL)

PRICE RS.276 **TARGET RS.257** **SELL**

Double whammy: Domestic gas price is due for revision from 1st October 2018 and expected to rise in line with the increase in international gas prices. Additionally, the rupee deprecation by ~13% (in 2018 till date) is adding to the woes of CGD companies and end-consumers.

Stock Details

Market cap (Rs mn)	:	183890
52-wk Hi/Lo (Rs)	:	345 / 240
Face Value (Rs)	:	2
3M Avg. daily vol (Nos)	:	2,602,929
Shares o/s (mn)	:	700

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	50,530	59,866	67,940
Growth (%)	20.1	18.5	13.5
EBITDA	11,144	12,745	14,794
EBITDA margin (%)	22.1	21.3	21.8
PAT	7,218	8,451	9,847
EPS	10.3	12.1	14.1
EPS Growth (%)	19.0	17.1	16.5
BV (Rs/share)	52.1	61.2	71.7
Dividend/share (Rs)	2.0	2.5	3.1
ROE (%)	21.2	20.8	20.6
ROCE (%)	21.2	20.8	20.6
P/E (x)	26.7	22.8	19.5
EV/EBITDA (x)	16.2	14.2	12.2
P/BV (x)	5.3	4.5	3.8

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	45.0	45.0	45.0
FII	20.1	21.3	24.8
DII	17.7	16.2	13.6
Others	17.5	17.5	16.6

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Indraprastha Gas	(10.1)	4.2	(11.9)
Nifty	1.3	8.0	12.6

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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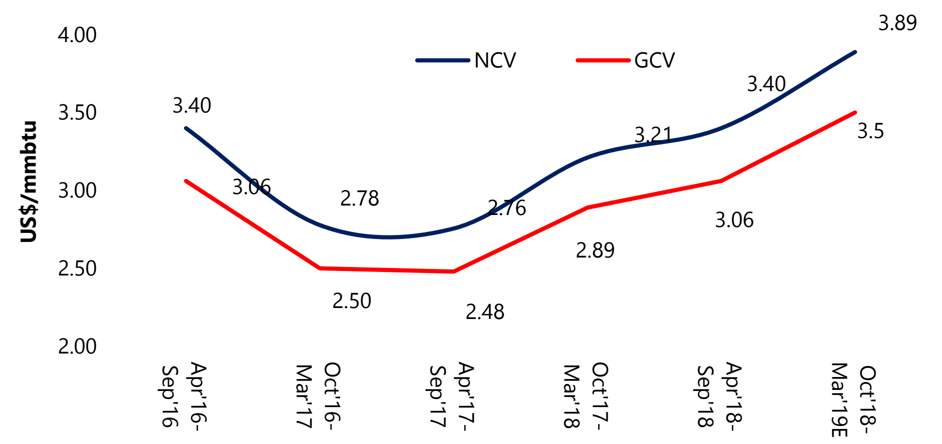
Domestic gas prices expected to rise meaningfully (US$/mmbtu)

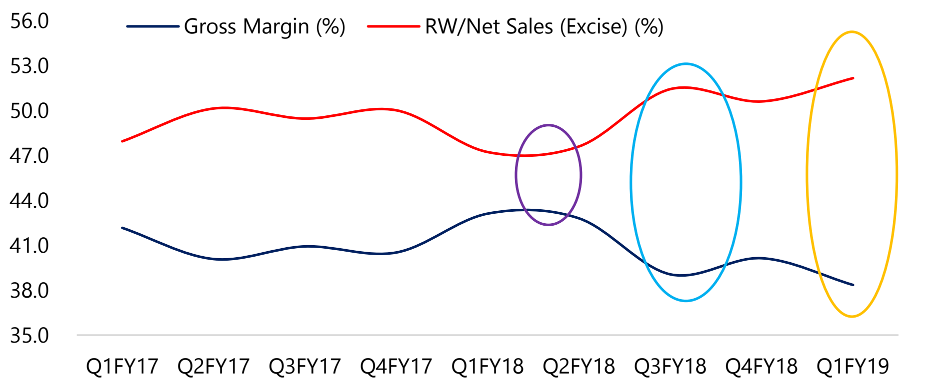


Source: PPAC and Kotak Securities - Private Client Research

INR depreciation against US$ will push PNG/CNG prices higher (INR/$)

Source: Bloomberg

IGL's quarterly gross margin gets negatively impacted with higher gas prices



Source: Company and Kotak Securities - Private Client Research

Recommendation

We expect IGL to book CNG gas volume of ~1112 mn Kgs and PNG volume of 527 mmscm in FY19E and CNG gas volume of ~1201 mn Kgs and PNG volume of 580 mmscm in FY20E. We expect an EPS of Rs.12.1 for FY19E and an EPS of Rs.14.1 for FY20E. Based on our estimates, the stock at current market price is trading at 12.2x EV/EBIDTA and 19.5x P/E on FY20E earnings. We believe that stock is expensively valued at current price and hence we maintain SELL rating on IGL with DCF based unchanged price target of Rs.257.

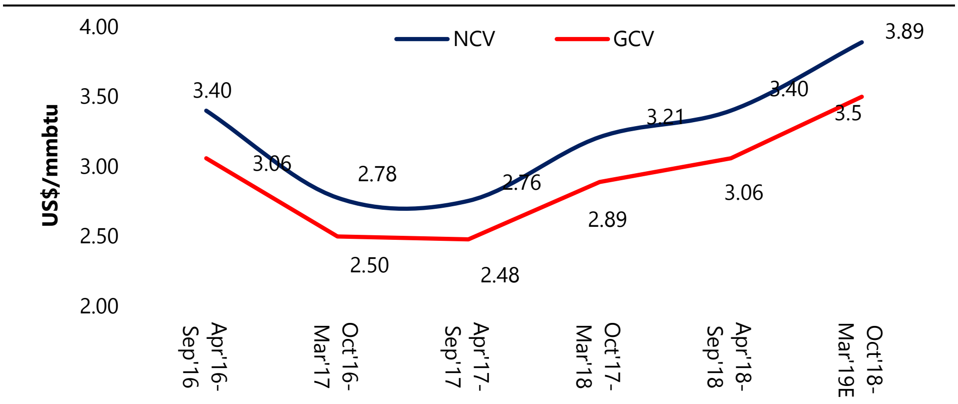
Key Highlights

- **Rising competition from OMCs:** Oil marketing companies are aggressively focusing on city gas distribution (CGD) and have recently participated and won CGD license under the ninth CGD bidding round launched by Petroleum and Natural Gas Regulatory Board (PNGRB). The success of downstream oil PSUs and private companies in the recent CGD bidding round, raise concerns of possible competition for the existing players in extant geographical areas as well in the long run.

- Bharat Gas Resources Ltd, a unit of state-owned BPCL, won licence for 11 cities like Amethi and Rai Bareli in Uttar Pradesh and Ahmednagar in Maharashtra, while Torrent Gas Pvt Ltd made nine winning bids that included ones for Alwar in Rajasthan, Moradabad in Uttar Pradesh and Karaikal in Puducherry. GAIL's retailing arm, GAIL Gas, managed rights for four cities, including Dehradun. However, IGL bagged a licence to retail CNG and PNG to households in Meerut, Muzaffarnagar and Shamli districts of Uttar Pradesh only. We believe the competition for existing CGD players are rising from new entrant.

- **Double whammy – Gas price/Weak rupee:** Domestic gas prices are due for revision from 1st October 2018 and expected to rise in line with the increase in international gas prices. Additionally, rupee deprecation by ~13% (in 2018 till date) is adding to the woes of CGD companies and end-consumers. We expect the growth in CNG consumption to moderate gradually given slower vehicles addition. Higher gas prices coupled with rupee depreciation will keep margins under preasure.

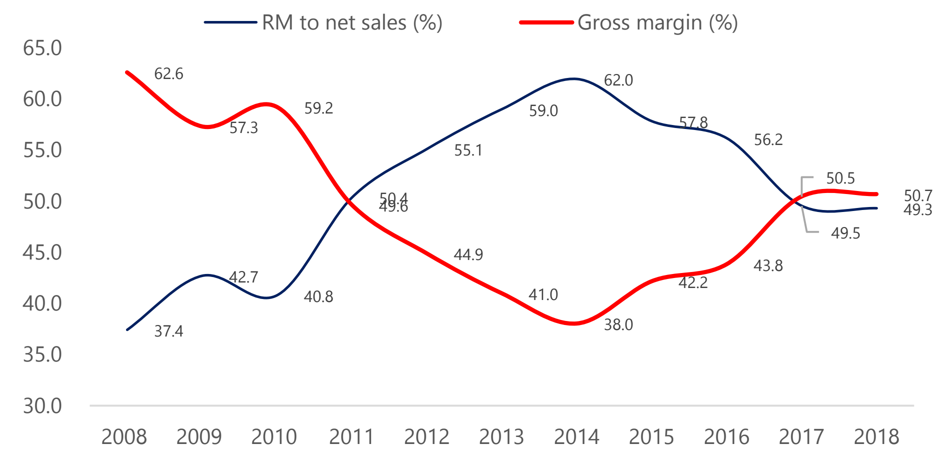
Domestic gas prices expected to rise meaningfully (US$/mmbtu)



Source: PPAC and Kotak Securities - Private Client Research

Trend showing inverse relation between IGL's gross margin and raw material cost

IGL is unable to pass on the full burden to end-consumer



Source: Company and Kotak Securities - Private Client Research

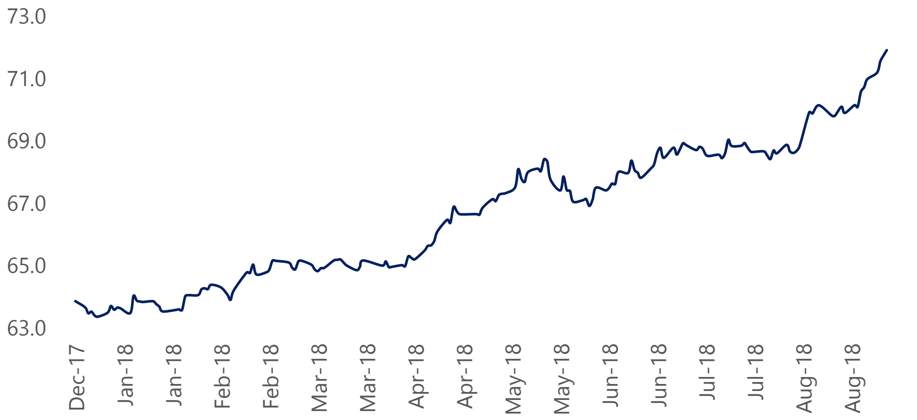
- **RLNG prices also moving up in line with higher crude oil prices:** In order to meet the rising domestic demand of natural gas, IGL not only sources KG-D6 gas and Administered price mechanism (APM) gas but also sources higher priced long-term RLNG as well as spot RLNG. Singapore LNG future has increased by 63% in FY19 till date. We expect industrial/commercial PNG consumption to slow down due to meaningful jump in LNG prices and weak currency.

LNG price future (US$/mmbtu)

Source: Bloomberg

- **Rupee depreciation:** We would like to highlight here that the price of gas supplied by RIL and ONGC is fixed by government in US dollar terms. Hence any rupee depreciation increases the cost for IGL and vice-a-versa.
- Recent rupee deprecation by ~13% (in 2018 till date) is adding to the woes of CGD companies and end-consumers.
- IGL has recently hiked gas prices but we believe this will not be sufficient to improve margins.

INR depreciation against US$ negative for gas consumer



Source: Bloomberg

Maintain SELL

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Key risks remain in terms of:

1). Sudden fall in crude oil prices and resultant fall in gas prices

2). Meaningful appreciation in rupee against US dollar

3). Higher CNG demand growth due to higher diesel prices.

Company background

Indraprastha Gas (IGL) is a City Gas Distribution company with rights to distribute CNG and PNG in Delhi and its adjoining areas. IGL was incorporated in 1998 as a JV between GAIL and Bharat Petroleum Corp. (BPCL). The government of Delhi owns another 5% stake. The company later took over the Delhi gas distribution project from GAIL. At present, IGL's gas distribution network spans over Delhi, Noida and Greater Noida, and Ghaziabad. The company supplies compressed natural gas (CNG) to the auto sector, piped natural gas (PNG) to households and commercial establishments, and R-LNG (re-gasified LNG) to industrial establishments.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	**42,060**	**50,530**	**59,866**	**67,940**
% change YoY	3.8	20.1	18.5	13.5
EBITDA	**9,637**	**11,144**	**12,745**	**14,794**
% change YoY	24.9	15.6	14.4	16.1
Other Income	1,085	1,645	1,879	2,019
Depreciation	1,671	1,813	1,898	1,988
EBIT	**9,051**	**10,977**	**12,726**	**14,825**
% change YoY	40.6	21.3	15.9	16.5
Net interest	12	17	17	17
Profit before tax	**9,039**	**10,960**	**12,709**	**14,808**
% change YoY	42.4	21.2	16.0	16.5
Tax	2,976	3,742	4,257	4,961
as % of PBT	32.9	34.1	33.5	33.5
Profit after tax	**6,063**	**7,218**	**8,451**	**9,847**
Minority interest	0	0	0	0
Share of profit of associates	0	0	0	0
Net income	**6,063**	**7,218**	**8,451**	**9,847**
% change YoY	45.7	19.0	17.1	16.5
Shares outstanding (m)	140	700	700	700
EPS (reported) (Rs)	**8.7**	**10.3**	**12.1**	**14.1**
CEPS (Rs)	11.0	12.9	14.8	16.9
DPS (Rs)	1.9	2.0	2.5	3.1

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	6,086	5,580	13,353	21,055
Accounts receivable	2,014	2,261	2,533	2,874
Inventories	517	524	524	524
Loans and Adv & Others	785	1,259	1,274	1,288
Current assets	9,402	9,624	17,683	25,741
Misc exp.	0	0	0	0
LT investments	7,839	13,160	13,160	13,160
Net fixed assets	24,689	28,181	29,181	30,181
Total assets	**41,930**	**50,965**	**60,024**	**69,081**
Payables	2,740	3,386	4,049	4,560
Others	6,490	8,376	10,342	11,528
Current liabilities	9,230	11,762	14,391	16,088
Provisions	560	137	163	185
LT debt	0	0	0	0
Others	2,024	2,596	2,596	2,596
Equity	1,400	1,400	1,400	1,400
Reserves	28,717	35,070	41,474	48,813
Total liabilities	**41,930**	**50,965**	**60,024**	**69,081**
BVPS (Rs)	43	52	61	72

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	9,051	10,977	12,726	14,825
Depreciation	1,671	1,813	1,898	1,988
Change in working capital	3,123	2,303	2,368	1,364
Chgs in other net current assets				
Operating cash flow	13,845	15,093	16,992	18,177
Interest	(12)	(17)	(17)	(17)
Tax	(2,976)	(3,742)	(4,257)	(4,961)
Cash flow from operations	**10,857**	**11,334**	**12,717**	**13,199**
Capex	(3,315)	(5,304)	(2,898)	(2,988)
(Inc)/dec in investments	(5,248)	(5,321)	-	-
Cash flow from investments	**(8,563)**	**(10,625)**	**(2,898)**	**(2,988)**
Others	1,473	773	-	(0)
Increase/(decrease) in debt	-	-	-	-
Proceeds from share premium	-	-	-	-
Dividends	(2,219)	(1,988)	(2,047)	(2,509)
Cash flow from financing	**(746)**	**(1,214)**	**(2,047)**	**(2,509)**
Opening cash	4,538	6,086	5,580	13,353
Closing cash	6,086	5,580	13,353	21,055

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	22.9	22.1	21.3	21.8
EBIT margin (%)	21.5	21.7	21.3	21.8
Net profit margin (%)	14.4	14.3	14.1	14.5
Receivables (days)	19.2	15.4	15.4	15.4
Inventory (days)	6.3	5.4	4.5	4.0
Sales/gross assets(x)	1.5	1.5	1.5	1.4
Interest coverage (x)	NM	NM	NM	NM
Debt/equity ratio(x)	-	-	-	-
ROE (%)	21.7	21.2	20.8	20.6
ROCE (%)	21.8	21.2	20.8	20.6
EV/ Sales	4.3	3.6	3.0	2.7
EV/EBITDA	18.7	16.2	14.2	12.2
Price to earnings (P/E)	31.7	26.7	22.8	19.5
Price to book value (P/B)	6.4	5.3	4.5	3.8

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	-	We advise investor to subscribe to the IPO.
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NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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