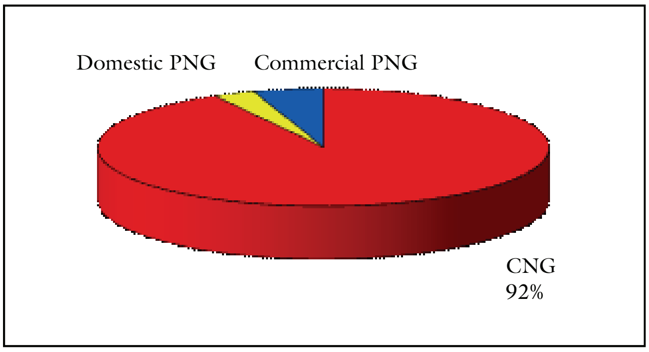
INDRAPRASTHA GAS LIMITED

Indraprastha Gas (IGL) is the sole supplier of compressed natural gas (CNG) and piped natural gas (PNG) in Delhi and surrounding areas. The company has a market capitalisation of around $450m and is 50% owned by government controlled entities, including the State Government of Delhi, which owns 5%.

IGL operates 181 CNG stations and supplies Delhi's public transport sector (including the largest CNG powered bus fleet in the world), and private vehicle users. CNG is an environmentally-friendly fuel and is much cheaper than diesel and petrol.

IGL also installs and transmits PNG to commercial and residential users, for which it currently has 140,000 customers.

Breakdown of Gas Sales



In this case study we will outline the investment process that led to our investment in this company.

Investment Themes

Utilities in Developing Economies

Urbanisation and increased government spending on infrastructure in emerging markets in Asia led us to utilities. We look for companies in this sector because we are attracted to their growth potential and their high quality earnings. The non-discretionary nature of demand for their product tends to protect utilities from down turns in the economy.

Within this theme we are particularly attracted to natural gas; partly because increased vehicle penetration in emerging markets will drive demand, but also because of its environmental and cost advantages.

We monitor several natural gas suppliers across Asia and currently invest in two gas companies in India, including Indraprastha Gas, as well as one in Indonesia.

Industry Focus: Natural Gas in India

All of India's leading automobile manufacturers are developing engines that run on CNG as the availability of natural gas increases and city gas distribution networks proliferate across the country. This increases the acceptability of CNG powered cars as it avoids the warranty and safety issues associated with privately fitted CNG conversion kits.

Company Research

As the sole supplier of natural gas to Delhi and its surrounds, IGL stands out as a utility company. It has no debt and generates a high return on equity (even without financial gearing). Strong operating cash flow is assisted by negative working capital.

On the Horizon for IGL

The Delhi state government is planning to add about 2,500 new high capacity CNG operative buses to its public transport system to streamline travel during the Commonwealth Games in 2010. IGL also expects an addition of over 20,000-30,000 CNG operative taxis in Delhi over the next couple of years. In addition to this, the Delhi State government recently directed all light commercial vehicles to convert to CNG (around 15,000 vehicles).

Strengths and Opportunities

In the year to March 2009, IGL had sales of around $180m, net profit of $35m and achieved an EBIT margin of 31%.

IGL has the first mover advantage in Delhi. As the supplier of natural gas to the city, IGL has marketing exclusivity until the end of 2011 and infrastructure exclusivity until 2023. The company's infrastructure exclusivity is renewable every ten years, meaning that it is effectively permanent. By the end of its marketing exclusivity period, IGL will have a network of 230 CNG stations that will substantially cover the Delhi city area. IGL enjoys confirmed regulated infrastructure returns of 21% (pre tax) on capital employed and has a firm gas allocation from GAIL and Reliance Krishna Godavari Basin.

The large number of IGL stations across Delhi enables easy access and this, combined with the considerable fuel economies, has already started a trend of conversion of private vehicles. At the present time, around 3,500 private vehicles per month are undergoing discretionary conversion to CNG.

IGL's PNG business also has substantial room for growth; as of March 2009, IGL supplied PNG to (only) 147,000 households. The company has a target of adding 50,000 new households (or a third of its current customer base) to this number each year to meet the huge untapped demand for PNG in Delhi. To put this opportunity in perspective: Beijing a city of 17m people (only 20% larger than Delhi's 14m) has over 3.5m PNG users, or 25 times the number which Delhi currently has!

Possible Challenges Ahead

The picture above reflects the long queues which IGL customers face. The long wait has been a limitation on growth. IGL currently plans to increase the compression capacity (which enables faster filling) at its existing CNG stations and also plans to add another 50 stations by 2010.

IGL currently benefits from a below market, subsidised gas cost. We expect this cost to increase over the coming years, and we reflect this increase in our numbers. This could affect profitability if IGL is unable to pass these higher costs on to consumers. IGL's returns may also be affected by political interventions.

IGL's market exclusivity ends in 2011, which will create the threat of competition from private players. IGL's first mover advantage and well-established presence (which by that date should be 230 stations and a large pipeline network across Delhi and over a decade of market exposure) should ensure that IGL remains the leading player in its field.

A possible reduction in the prices of competing fuels (such as petrol or LPG) may affect the cost-benefit ratio of converting to CNG. However, whilst these margins may narrow, natural gas is likely to remain the cheapest fuel option.

We have identified all of these issues in our assessment of the company but remain very positive on its prospects.

Review

We first bought IGL in January 2007 and have increased our stake as we have grown more comfortable with the business and its prospects.

IGL has grown to become the Fund's fourth largest investment, and our largest infrastructure holding in India.

The shares are up over 50% since our initial purchases, but we are very confident about its long term prospects and still think that there is significant upside.