

ADD

TP: Rs 870 | ▲ 11%

MAHANAGAR GAS

Oil & Gas

09 August 2019

Margins surge, volumes drag; raise to ADD on positive risk-reward

Mahanagar Gas's (MAHGL) Q1FY20 PAT was well above estimates at Rs 1.7bn (+20% YoY). While EBITDA margins surged to Rs 10.3/scm (+20% YoY), volumes underperformed at 270mmscm (+3.3% YoY) as the company seemed to fall back on its earnings growth strategy of margin expansion at the cost of volumes. We raise FY20/FY21 earnings by 22%/16% on higher margins. Our DCF-based TP improves to Rs 870 (vs. Rs 800) on rollover to Sep'21 valuations and lower COE. We upgrade the stock to ADD (from SELL).

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Drag from CNG weighs on volume growth: MAHGL's volumes have once again reverted to subpar growth levels, slowing to 3.3% YoY in Q1 (270mmscm). CNG (197mmscm, +2% YoY) was muted due to a high base and slowdown in the addition/conversion rate of vehicles using this fuel. We believe the slowdown in CNG volume growth could sustain over the long term given rising infrastructure constraints and improving alternate travel options in Mumbai (metro).

Robust PNG volumes: PNG volumes grew 7% YoY backed by domestic PNG sales (36mmscm, +9.4% YoY), while offtake from the industrial/commercial segments slowed (37mmscm, +4.7% YoY). Unlike CNG, PNG volumes do not face similar infrastructure constraints.

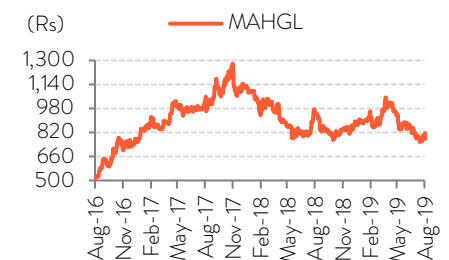
Margins surge: EBITDA margins at Rs 10.3/scm were well above estimates, driven by a surge in margins for the industrial/commercial segments from a crash in spot LNG prices. This level seems sustainable on a low LNG price outlook. We raise long-term average margin estimates to ~Rs 10/scm (vs. Rs 8).

Upgrade to ADD: At ~11x FY21E EPS, MAHGL's valuations price in the volume slowdown, while improving margins proffer hope for sustained earnings growth. We upgrade to ADD as the recent correction makes risk-reward favourable.

Ticker/Price	MAHGL IN/Rs 785
Market cap	US\$ 1.1bn
Shares o/s	99mn
3M ADV	US\$ 4.5mn
52wk high/low	Rs 1,067/Rs 754
Promoter/FPI/DII	43%/24%/33%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	4,779	5,464	6,937	6,914	7,167
Adj. EPS (Rs)	48.4	55.3	70.2	70.0	72.6
Adj. EPS growth (%)	21.5	14.3	27.0	(0.3)	3.7
Adj. ROAE (%)	24.3	24.2	27.2	24.4	23.0
Adj. P/E (x)	16.2	14.2	11.2	11.2	10.8
EV/EBITDA (x)	9.8	8.7	6.7	6.5	6.2

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	7,575	6,323	19.8	7,225	4.8
Raw Material Consumed	3,482	2,929	18.9	3,665	(5.0)
% of sales	46.0	46.3	-	50.7	-
Other expenditure	1,324	1,155	14.7	1,421	(6.8)
% of sales	17.5	18.3	-	19.7	-
EBITDA	2,768	2,239	23.7	2,140	29.4
EBITDA margin (%)	36.5	35.4	-	29.6	-
EBITDA (Rs/scm)	10.3	8.6	19.7	7.9	29.6
Depreciation and amortization	372	295	26.0	329	13.1
Interest	14	1	2,183.3	1	2,640.0
Other income	203	153	32.6	238	(14.6)
Profit Before Tax	2,586	2,096	23.4	2,049	26.2
Provision for tax	884	684	29.2	714	23.8
Reported PAT	1,702	1,413	20.5	1,205	41.2
Other comprehensive income	6	3	-	-	-
Total income	1,709	1,415	20.7	1,335	28.0
NPM (%)	22.5	22.3	-	18.5	-
Reported EPS (Rs)	17.2	14.3	20.5	13.5	27.6

Source: Company, BOBCAPS Research | *Adjusted for one-time commission payment to OMCs

FIG 2 – VOLUME BREAKUP

	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
CNG volumes (mmscm)	197	193	2.0	198	(0.3)
PNG volumes (mmscm)	73	68	7.0	73	0.3
- Industrial/Commercial	37	35	4.7	38	(2.7)
- Domestic	36	33	9.4	35	3.5
Total volumes (mmscm)	270	261	3.3	270	(0.2)
Total volumes (mmscmd)	2.97	2.87	3.3	3.01	(1.3)

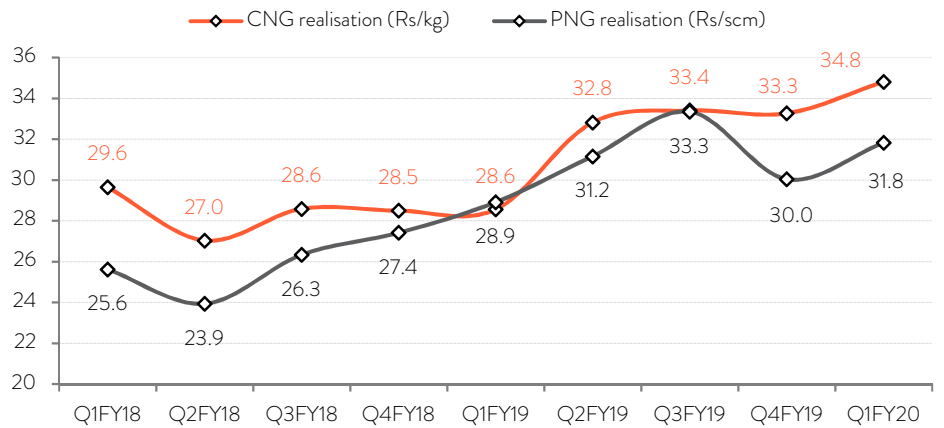
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Avg realisation (Rs/scm)	28.0	24.2	16.0	26.7	5.0
Gas cost (Rs/scm)	12.9	11.2	15.1	13.6	(4.8)
Gross spreads (Rs/scm)	15.2	13.0	16.7	13.2	15.1
CNG realisation (Rs/kg)	34.8	28.6	21.9	33.3	4.6
PNG realisation (Rs/scm)	31.8	28.9	10.1	30.0	6.0
EBITDA (Rs/scm)	10.3	8.6	19.7	7.9	29.6
Other operating costs (Rs/scm)	4.9	4.4	11.0	5.3	(6.6)

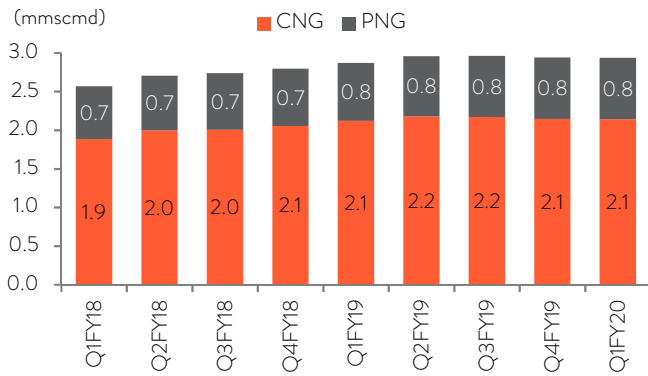
Source: Company, BOBCAPS Research | *Adjusted for one-time commission payment to OMCs

FIG 4 – CNG AND PNG REALISATIONS



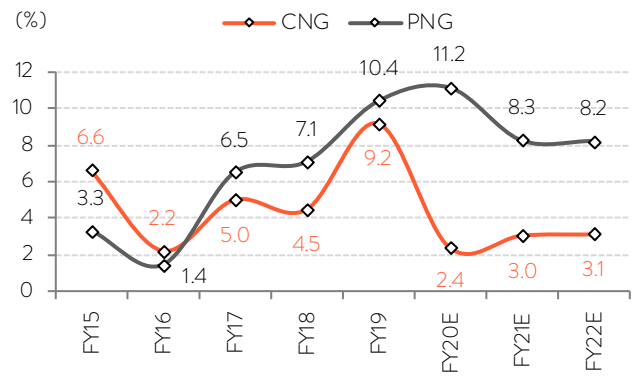
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Earnings call highlights

CNG

- Management believes the current macro has proven favourable for CNG where volumes continued to grow despite the downturn in auto sales, as CNG vehicle sales have bucked the trend and improved YoY for most large OEMs.
- MAHGL has 240 stations (including 170 in collaboration with OMCs), and plans to add 46 new CNG stations in FY20.
- Plans are underway to set up 3-4 LCNG stations. In the initial stages, these would only supply CNG and then gradually supply LNG once such vehicles become available.

PNG

- Margin improvement was mainly driven by the industrial and commercial segments as these entirely consume spot LNG (prices of which have crashed to <US\$ 4/mmbtu). Management expects spot LNG prices to remain soft over the next two quarters.
- Average realisations for commercial/industrial PNG volumes were at Rs 38/scm and Rs 33/scm respectively, forming 8% and 6% of total volumes. Management indicated that it has ~3,700 customers in these two segments, of which 3,400 are commercial, 80 are large industries and 200 are small industries.

Other highlights

- Management has guided for annual capex of ~Rs 4bn/year over FY20-FY22.
- About Rs 0.5bn capex has been incurred in Raigad. Management plans to spend an additional ~Rs 0.75bn-1bn here in FY20. The overall volume potential of Raigad is 0.6-0.7mmscmd (currently averaging ~0.03mmscmd).
- Management does not believe the industry is saturated as penetration in the commercial segment is only 30%, and industrial volumes still look buoyant from geographic areas GA2 & GA3.

Valuation methodology

MAHGL seems to have fallen back on its FY13-FY19 earnings growth strategy of margin expansion at the cost of volumes. We raise FY20/FY21 earnings by 22%/16% on higher margins. We also introduce FY22 estimates, building in 4% earnings growth. Our DCF-based target price improves to Rs 870 (vs. Rs 800) on rollover to Sep'21 valuations and lower COE.

MAHGL continues to enjoy one of the highest margins among its listed CGD peers. At ~11x FY21E EPS, valuations price in the current volume slowdown even as new areas such as Raigad (FY21 onwards) offer hope for revival. We upgrade the stock to ADD (from SELL) as the recent correction turns risk-reward favourable.

FIG 7 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	36,104	33,658	(6.8)	41,169	36,422	(11.5)	39,465
EBITDA	9,292	11,201	20.5	9,733	11,264	15.7	11,758
EBITDA margin (%)	25.7	33.3	-	23.6	30.9	-	29.8
PAT	5,700	6,937	21.7	5,940	6,914	16.4	7,167
PAT margin (%)	15.8	20.6	-	14.4	19.0	-	18.2
EPS (Rs)	57.7	70.2	21.7	60.1	70.0	16.4	72.6

Source: BOBCAPS Research

FIG 8 – VALUATION SUMMARY

Valuation parameters	(Rs mn)
WACC (%)	10.2
Terminal Year growth (%)	5.0
PV of FCF	18,366
PV of terminal value	57,638
Firm Value	76,004
Less Net Debt	(9,714)
Equity value	85,717
MAHGL Value (Rs/share)	870

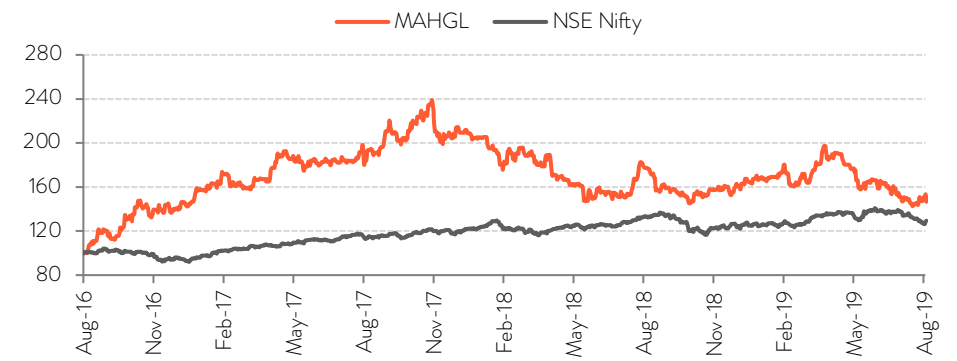
Source: BOBCAPS Research

FIG 9 – SENSITIVITY OF FAIR VALUE TO WACC AND TERMINAL GROWTH

		WACC (%)				
		(Rs)	8.2	9.2	10.2	11.2
Terminal growth (%)	5	931	800	705	633	576
	4	1,083	899	773	683	614
	5	1,332	1,045	870	748	661
	6	1,811	1,283	1,008	839	724
	7	3,117	1,743	1,238	974	811

Source: BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- below-expected operating margins,
- lower-than-estimated volume growth for CNG and PNG, and
- slower-than-expected expansion of MAHGL’s areas of operation due to possible delays in city allocation in the upcoming bidding rounds announced by PNGRB.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Total revenue	22,330	27,911	33,658	36,422	39,465
EBITDA	7,801	8,855	11,201	11,264	11,758
EBIT	6,689	7,595	9,733	9,632	9,949
Net interest income/(expenses)	(1)	(3)	(1)	0	0
Other income/(expenses)	577	777	827	893	961
EBT	7,265	8,369	10,559	10,524	10,909
Income taxes	(2,486)	(2,905)	(3,622)	(3,610)	(3,742)
Reported net profit	4,779	5,464	6,937	6,914	7,167
Adjusted net profit	4,779	5,464	6,937	6,914	7,167

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Accounts payables	1,100	1,524	1,323	1,493	1,646
Other current liabilities	6,081	5,179	6,153	6,893	7,591
Provisions	207	212	768	766	794
Debt funds	12	11	10	9	8
Other liabilities	1,748	2,039	2,578	3,115	3,671
Equity capital	988	988	988	988	988
Reserves & surplus	19,966	23,199	25,879	28,748	31,722
Shareholders' fund	20,953	24,187	26,867	29,736	32,710
Total liabilities and equities	30,102	33,152	37,698	42,011	46,420
Cash and cash eq.	919	2,988	4,121	5,228	6,868
Accounts receivables	916	995	1,291	1,397	1,514
Inventories	240	191	277	299	324
Other current assets	2,266	958	958	958	958
Investments	6,877	6,736	7,236	7,736	8,236
Net fixed assets	15,319	17,588	19,229	21,077	22,831
CWIP	3,566	3,697	4,588	5,316	5,689
Total assets	30,102	33,153	37,699	42,011	46,420

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net income + Depreciation	5,891	6,723	8,405	8,547	8,976
Changes in working capital	581	804	947	779	738
Other operating cash flows	(208)	(486)	(288)	(356)	(404)
Cash flow from operations	6,263	7,041	9,064	8,970	9,310
Capital expenditures	(2,835)	(3,658)	(4,000)	(4,210)	(3,935)
Change in investments	(2,210)	141	(500)	(500)	(500)
Cash flow from investing	(5,045)	(3,517)	(4,500)	(4,710)	(4,435)
Debt raised/repaid	(15)	(1)	(1)	(1)	(1)
Dividends paid	(2,353)	(3,197)	(4,059)	(4,046)	(4,194)
Other financing cash flows	707	1,743	629	893	961
Cash flow from financing	(1,661)	(1,455)	(3,431)	(3,153)	(3,234)
Changes in cash and cash eq.	(442)	2,069	1,132	1,107	1,641
Closing cash and cash eq.	919	2,988	4,121	5,228	6,868

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
Reported EPS	48.4	55.3	70.2	70.0	72.6
Adjusted EPS	48.4	55.3	70.2	70.0	72.6
Dividend per share	19.0	27.7	35.1	35.0	36.3
Book value per share	212.1	244.9	272.0	301.0	331.1

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
EV/Sales	3.4	2.7	2.2	2.0	1.8
EV/EBITDA	9.8	8.7	6.7	6.5	6.2
Adjusted P/E	16.2	14.2	11.2	11.2	10.8
P/BV	3.7	3.2	2.9	2.6	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	65.8	65.3	65.7	65.7	65.7
Interest burden (PBT/EBIT)	108.6	110.2	108.5	109.3	109.7
EBIT margin (EBIT/Revenue)	30.0	27.2	28.9	26.4	25.2
Asset turnover (Revenue/Avg TA)	79.3	88.2	95.0	91.4	89.3
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.4
Adjusted ROAE	24.3	24.2	27.2	24.4	23.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	9.8	25.0	20.6	8.2	8.4
EBITDA	21.1	13.5	26.5	0.6	4.4
Adjusted EPS	21.5	14.3	27.0	(0.3)	3.7
Profitability & Return ratios (%)					
EBITDA margin	34.9	31.7	33.3	30.9	29.8
EBIT margin	30.0	27.2	28.9	26.4	25.2
Adjusted profit margin	21.4	19.6	20.6	19.0	18.2
Adjusted ROAE	24.3	24.2	27.2	24.4	23.0
ROCE	22.3	22.0	25.0	22.4	20.9
Working capital days (days)					
Receivables	15	12	12	13	13
Inventory	8	6	5	6	6
Payables	29	25	23	20	21
Ratios (x)					
Gross asset turnover	1.0	1.1	1.1	1.1	1.1
Current ratio	0.6	0.7	0.8	0.9	1.0
Net interest coverage ratio	7,399.6	2,373.5	19,050.3	20,946.5	24,041.3
Adjusted debt/equity	0.0	(0.1)	(0.2)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

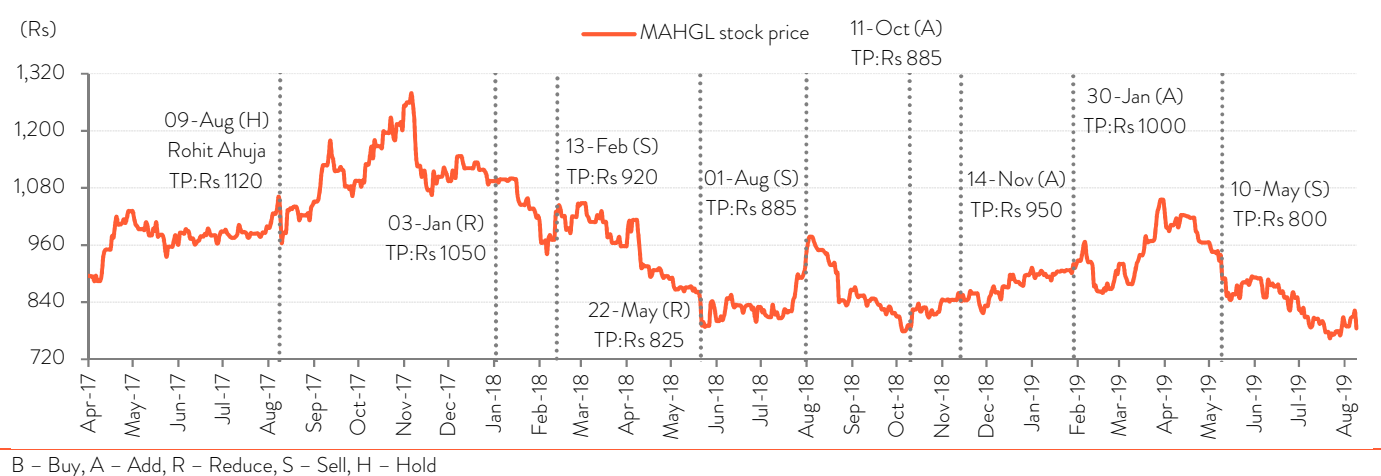
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: MAHANAGAR GAS (MAHGL IN)



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