

SELL

TP: Rs 750 | ▼ 23%

MAHANAGAR GAS

Oil & Gas

10 August 2020

Muted volume outlook

Mahanagar Gas's (MAHGL) Q1FY21 PAT underperformed at Rs 0.45bn (-73% YoY). EBITDA margins declined to Rs 7.9/scm (-23% YoY) on a crash in CNG volumes (-78% YoY) and overall volumes disappointed at 101mmscm (-63% YoY). An extended lockdown in the Mumbai region could keep CNG volumes sluggish till Q3FY21. Volume growth revival beyond FY21 also looks challenging given saturation in existing areas of operations. Our TP changes to Rs 750 (from Rs 710) as we roll over to Sep'21. Maintain SELL.

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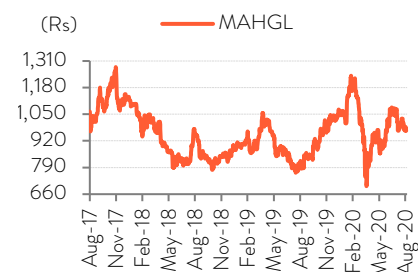
Volumes crash during lockdown: CNG volumes fell the most, declining 78% YoY to 44mmscm, against an overall volume decline of 63% to 101mmscm. Sluggishness in CNG volumes could continue through H2FY21 considering the extended lockdown in Mumbai. Over the long term, rising infrastructure constraints for CNG retail outlet expansion and improving alternate travel options (metro) in Mumbai suggest CNG volume growth may remain weak.

Margins decline on sluggish volumes: Q1 EBITDA was muted at Rs 0.8bn (-71% YoY) as margins contracted to Rs 7.9/scm (-23% YoY). Although gas prices declined, margins were under pressure due to the steep drop in volumes, especially for the high-margin CNG segment. As volumes take longer to revive, MAHGL may not be able to cash in on lower gas costs.

Maintain SELL: Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter. Expansion into new areas could also be delayed due to the pandemic impact. Additionally, PNGRB regulations on marketing exclusivity raise concerns over potential competition emerging for MAHGL in Mumbai, especially in the high-margin CNG segment.

| | |
|------------------|-----------------|
| Ticker/Price | MAHGL IN/Rs 968 |
| Market cap | US\$ 1.3bn |
| Shares o/s | 99mn |
| 3M ADV | US\$ 13.2mn |
| 52wk high/low | Rs 1,246/Rs 664 |
| Promoter/FPI/DII | 33%/30%/38% |

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20P | FY21E | FY22E | FY23E |
|-------------------------|--------|--------|--------|--------|--------|
| Total revenue (Rs mn) | 27,911 | 29,721 | 27,877 | 32,819 | 34,866 |
| EBITDA (Rs mn) | 8,855 | 10,528 | 10,626 | 12,112 | 12,382 |
| Adj. net profit (Rs mn) | 5,467 | 7,935 | 7,437 | 8,381 | 8,408 |
| Adj. EPS (Rs) | 55.3 | 80.3 | 75.3 | 84.8 | 85.1 |
| Adj. EPS growth (%) | 14.4 | 45.1 | (6.3) | 12.7 | 0.3 |
| Adj. ROAE (%) | 24.2 | 29.5 | 23.9 | 24.4 | 22.2 |
| Adj. P/E (x) | 17.5 | 12.1 | 12.9 | 11.4 | 11.4 |
| EV/EBITDA (x) | 10.7 | 8.9 | 8.8 | 7.6 | 7.3 |

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

| Y/E March (Rs mn) | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) |
|--------------------------|--------------|--------------|---------------|--------------|---------------|
| Net sales | 2,618 | 7,575 | (65.4) | 6,866 | (61.9) |
| Raw Material Consumed | 988 | 3,482 | (71.6) | 2,985 | (66.9) |
| % of sales | 37.8 | 46.0 | - | 43.5 | - |
| Other expenditure | 829 | 1,324 | (37.4) | 1,442 | (42.5) |
| % of sales | 31.7 | 17.5 | - | 21.0 | - |
| EBITDA | 800 | 2,768 | (71.1) | 2,438 | (67.2) |
| EBITDA margin (%) | 30.6 | 36.5 | - | 35.5 | - |
| EBITDA (Rs/scm) | 7.9 | 10.3 | (23.0) | 9.6 | (17.9) |
| Depn and amortization | 423 | 372 | 13.6 | 440 | (3.9) |
| Interest | 15 | 14 | 11.7 | 21 | (26.4) |
| Other income | 245 | 203 | 20.6 | 270 | (9.1) |
| Profit Before Tax | 607 | 2,586 | (76.5) | 2,247 | (73.0) |
| Provision for tax | 155 | 884 | (82.5) | 581 | (73.4) |
| - effective tax rate (%) | 25.5 | 34.2 | - | 25.9 | - |
| PAT (reported) | 453 | 1,702 | (73.4) | 1,537 | (70.6) |
| Total income | 459 | 1,706 | (73.1) | 1,672 | (72.6) |
| Reported EPS (Rs) | 4.6 | 17.2 | (73.4) | 16.9 | (72.8) |

Source: Company, BOBCAPS Research

FIG 2 – VOLUME BREAKUP

| | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) |
|-------------------------------|-------------|-------------|---------------|-------------|---------------|
| CNG Volumes (mmscm) | 44 | 197 | (77.8) | 180 | (75.7) |
| PNG Volumes (mmscm) | 58 | 73 | (21.2) | 73 | (21.3) |
| Industrial/Commercial | 19 | 37 | (49.3) | 35 | (47.0) |
| Domestic | 39 | 36 | 7.1 | 38 | 2.2 |
| Total Volumes (mmscm) | 101 | 270 | (62.5) | 253 | (60.0) |
| Total Volumes (mmscmd) | 1.11 | 2.97 | (62.5) | 2.82 | (60.5) |

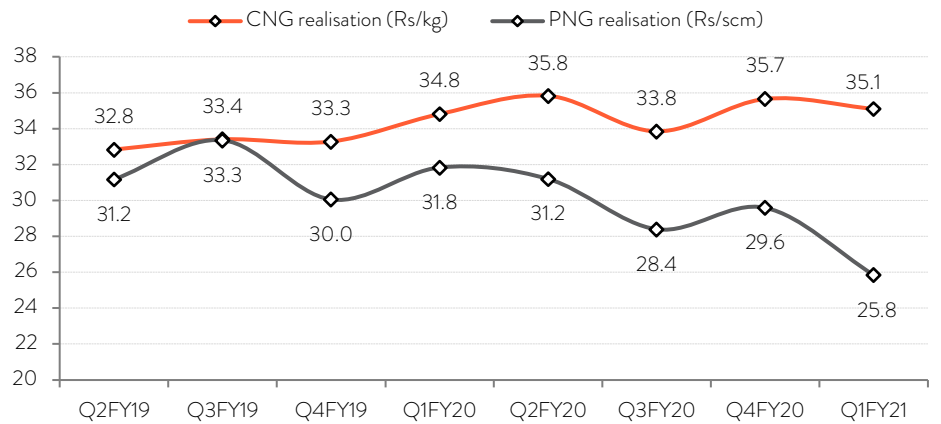
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

| | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) |
|---------------------------------------|-------------|-------------|---------------|-------------|---------------|
| Avg realisation (Rs/scm) | 25.8 | 28.0 | (7.9) | 27.1 | (4.6) |
| Gas cost (Rs/scm) | 9.8 | 12.9 | (24.3) | 11.8 | (17.2) |
| Gross Spreads (Rs/scm) | 16.1 | 15.2 | 6.1 | 15.3 | 5.0 |
| CNG Realisation (Rs/kg) | 35.1 | 34.8 | 0.8 | 35.7 | (1.6) |
| PNG Realisation (Rs/scm) | 25.8 | 31.8 | (18.8) | 29.6 | (12.6) |
| EBITDA (Rs/scm) | 7.9 | 10.3 | (23.0) | 9.6 | (17.9) |
| Other operating costs (Rs/scm) | 8.2 | 4.9 | 67.0 | 5.7 | 43.9 |

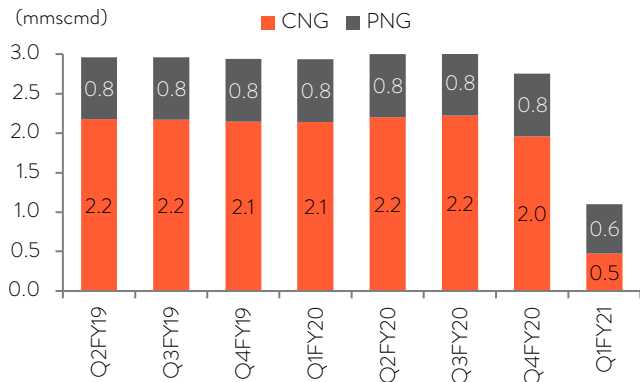
Source: Company, BOBCAPS Research

FIG 4 – CNG AND PNG REALISATIONS



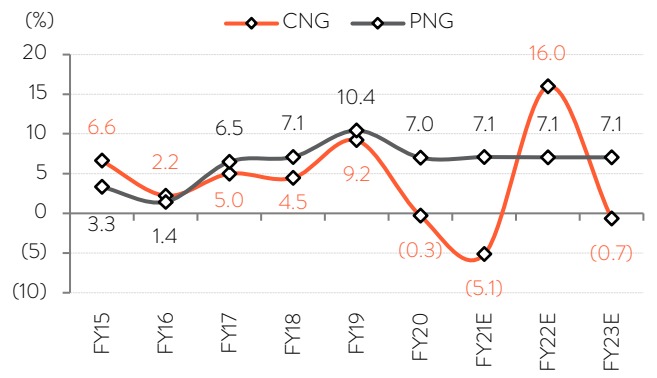
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Earnings call highlights

- Sale volumes are expected to pick up shortly given the reopening of restaurants and industries. Commercial PNG is at ~50% of pre-Covid levels and is expected to recover faster than other segments.
- Volume breakup for Q1 is as follows: industrials 0.146mmscmd, commercial 0.58mmscmd, domestic 0.429mmscmd and CNG 0.48mmscmd. About 50% of the overall ~350,000 autorickshaws in Mumbai are back in operation.
- Last year, BEST planned to add 500 CNG buses, of which 300 have been inducted and ~150 should be inducted by Aug/Sep'20. This will take the count to 2,350 buses. Additionally, it plans to add another 800-1,000 buses at a later stage. These talks are at an advanced stage with the Maharashtra state government but the process has slowed due to the Covid situation.
- MGL has 256 stations of which 184 are at OMC outlets.
- Gas sourcing during the quarter was predominantly from the spot market.
- MAHGL continues to face labour shortage issues and is working out incentives for labourers to return.
- Capex planned for FY21 totals ~Rs 5.5bn and no borrowing is anticipated for the same.

Valuation methodology

The extended lockdown in the Mumbai region could keep CNG volumes sluggish till Q3FY21. Volume growth revival beyond FY21 also looks challenging given saturation in existing areas of operations. Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter.

Expansion into new areas could also be delayed due to the pandemic impact. Additionally, PNGRB regulations on marketing exclusivity raise concerns over potential competition emerging for MAHGL in Mumbai, especially in the high-margin CNG segment. Maintain SELL as we roll forward to a revised Sep'21 DCF-based target price of Rs 750 (from Rs 710).

FIG 7 – REVISED ESTIMATES

| (Rs mn) | FY21E | | | FY22E | | | FY23E |
|-------------------|--------|--------|---------|--------|--------|---------|--------|
| | Old | New | Var (%) | Old | New | Var (%) | New |
| Revenue | 36,329 | 27,877 | (23.3) | 39,201 | 32,819 | (16.3) | 34,866 |
| EBITDA | 11,382 | 10,626 | (6.6) | 11,852 | 12,112 | 2.2 | 12,382 |
| EBITDA margin (%) | 31.3 | 38.1 | - | 30.2 | 36.9 | - | 35.5 |
| PAT | 8,007 | 7,437 | (7.1) | 8,298 | 8,381 | 1.0 | 8,408 |
| PAT margin (%) | 22.0 | 26.7 | - | 21.1 | 25.5 | - | 24.1 |
| EPS (Rs) | 81.1 | 75.3 | (7.2) | 84.0 | 84.8 | 1.0 | 85.1 |

Source: Company, BOBCAPS Research

FIG 8 – VALUATION SUMMARY

| Valuation parameters | (Rs mn) |
|--------------------------------|------------|
| WACC (%) | 9.9 |
| Terminal Year growth (%) | 2.0 |
| PV of FCF | 15,351 |
| PV of terminal value | 45,302 |
| Firm Value | 60,652 |
| Less Net Debt | (13,553) |
| Equity value | 74,205 |
| Equity Value (Rs/share) | 750 |

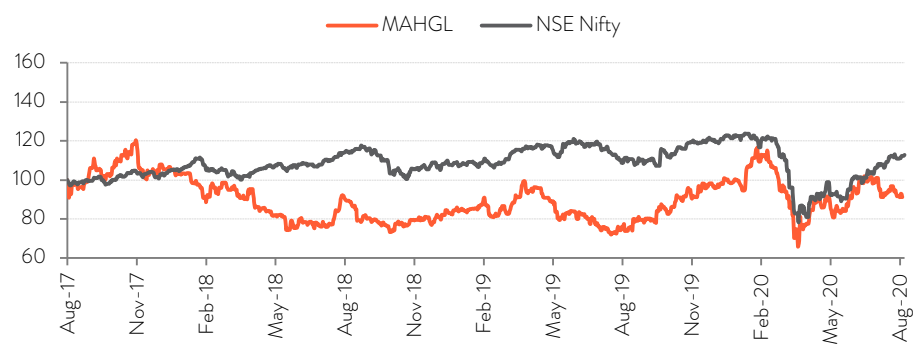
Source: BOBCAPS Research

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

| | | WACC (%) | | | | |
|---------------------|----------|----------|-------|------------|------------|------|
| | | (Rs) | 7.9 | 8.9 | 9.9 | 10.9 |
| Terminal growth (%) | 0 | 792 | 718 | 659 | 611 | 570 |
| | 1 | 863 | 772 | 701 | 643 | 597 |
| | 2 | 958 | 840 | 752 | 683 | 628 |
| | 3 | 1,092 | 932 | 819 | 733 | 667 |
| | 4 | 1,295 | 1,062 | 908 | 798 | 715 |

Source: BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our estimates are:

- above-expected operating margins,
- higher-than-estimated volume growth for CNG and PNG, and
- faster-than-expected expansion of MAHGL’s areas of operation on successful placement of winning bids in PNGRB’s upcoming CGD bidding rounds.

FINANCIALS

Income Statement

| Y/E 31 Mar (Rs mn) | FY19A | FY20P | FY21E | FY22E | FY23E |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|
| Total revenue | 27,911 | 29,721 | 27,877 | 32,819 | 34,866 |
| EBITDA | 8,855 | 10,528 | 10,626 | 12,112 | 12,382 |
| Depreciation | (1,259) | (1,617) | (1,700) | (1,902) | (2,144) |
| EBIT | 7,595 | 8,911 | 8,925 | 10,210 | 10,238 |
| Net interest income/(expenses) | 0 | (65) | 0 | 0 | 0 |
| Other income/(expenses) | 777 | 990 | 1,004 | 980 | 988 |
| EBT | 8,372 | 9,835 | 9,930 | 11,189 | 11,226 |
| Income taxes | (2,905) | (1,900) | (2,492) | (2,809) | (2,818) |
| Reported net profit | 5,467 | 7,935 | 7,437 | 8,381 | 8,408 |
| Adjusted net profit | 5,467 | 7,935 | 7,437 | 8,381 | 8,408 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY19A | FY20P | FY21E | FY22E | FY23E |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Accounts payables | 1,524 | 1,318 | 756 | 918 | 1,002 |
| Other current liabilities | 5,179 | 8,571 | 7,562 | 9,077 | 9,856 |
| Provisions | 212 | 263 | 274 | 308 | 309 |
| Debt funds | 11 | 0 | 0 | 0 | 0 |
| Other liabilities | 2,039 | 1,607 | 2,113 | 2,684 | 3,256 |
| Equity capital | 988 | 988 | 988 | 988 | 988 |
| Reserves & surplus | 23,199 | 28,539 | 31,625 | 35,102 | 38,590 |
| Shareholders' fund | 24,187 | 29,527 | 32,612 | 36,090 | 39,578 |
| Total liabilities and equities | 33,152 | 41,285 | 43,318 | 49,077 | 54,002 |
| Cash and cash eq. | 2,988 | 2,295 | 5,058 | 4,570 | 3,578 |
| Accounts receivables | 995 | 685 | 687 | 809 | 860 |
| Inventories | 191 | 186 | 153 | 180 | 191 |
| Other current assets | 958 | 1,268 | 1,268 | 1,268 | 1,268 |
| Investments | 6,736 | 11,495 | 8,495 | 10,495 | 12,495 |
| Net fixed assets | 17,588 | 20,446 | 22,205 | 24,924 | 27,815 |
| CWIP | 3,697 | 4,865 | 5,406 | 6,784 | 7,749 |
| Total assets | 33,153 | 41,239 | 43,271 | 49,030 | 53,956 |

Source: Company, BOBCAPS Research

Cash Flows

| Y/E 31 Mar (Rs mn) | FY19A | FY20P | FY21E | FY22E | FY23E |
|-------------------------------------|----------------|-----------------|----------------|----------------|----------------|
| Net income + Depreciation | 6,726 | 9,552 | 9,138 | 10,283 | 10,552 |
| Changes in working capital | 804 | 3,242 | (1,530) | 1,562 | 803 |
| Other operating cash flows | (486) | (1,420) | (498) | (409) | (415) |
| Cash flow from operations | 7,044 | 11,374 | 7,110 | 11,437 | 10,939 |
| Capital expenditures | (3,658) | (5,644) | (4,000) | (6,000) | (6,000) |
| Change in investments | 141 | (4,759) | 3,000 | (2,000) | (2,000) |
| Cash flow from investing | (3,517) | (10,403) | (1,000) | (8,000) | (8,000) |
| Debt raised/repaid | (1) | (11) | 0 | 0 | 0 |
| Dividends paid | (3,199) | (4,643) | (4,352) | (4,904) | (4,920) |
| Other financing cash flows | 1,742 | 2,988 | 1,004 | 980 | 988 |
| Cash flow from financing | (1,458) | (1,665) | (3,347) | (3,924) | (3,932) |
| Changes in cash and cash eq. | 2,069 | (694) | 2,763 | (487) | (992) |
| Closing cash and cash eq. | 2,988 | 2,295 | 5,058 | 4,570 | 3,578 |

Per Share

| Y/E 31 Mar (Rs) | FY19A | FY20P | FY21E | FY22E | FY23E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 55.3 | 80.3 | 75.3 | 84.8 | 85.1 |
| Adjusted EPS | 55.3 | 80.3 | 75.3 | 84.8 | 85.1 |
| Dividend per share | 27.7 | 40.2 | 37.6 | 42.4 | 42.6 |
| Book value per share | 244.9 | 298.9 | 330.2 | 365.4 | 400.7 |

Valuations Ratios

| Y/E 31 Mar (x) | FY19A | FY20P | FY21E | FY22E | FY23E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 3.4 | 3.2 | 3.3 | 2.8 | 2.6 |
| EV/EBITDA | 10.7 | 8.9 | 8.8 | 7.6 | 7.3 |
| Adjusted P/E | 17.5 | 12.1 | 12.9 | 11.4 | 11.4 |
| P/BV | 4.0 | 3.2 | 2.9 | 2.7 | 2.4 |

DuPont Analysis

| Y/E 31 Mar (%) | FY19A | FY20P | FY21E | FY22E | FY23E |
|---------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 65.3 | 80.7 | 74.9 | 74.9 | 74.9 |
| Interest burden (PBT/EBIT) | 110.2 | 110.4 | 111.3 | 109.6 | 109.6 |
| EBIT margin (EBIT/Revenue) | 27.2 | 30.0 | 32.0 | 31.1 | 29.4 |
| Asset turnover (Revenue/Avg TA) | 88.2 | 79.9 | 66.0 | 71.1 | 67.7 |
| Leverage (Avg TA/Avg Equity) | 1.4 | 1.4 | 1.4 | 1.3 | 1.4 |
| Adjusted ROAE | 24.2 | 29.5 | 23.9 | 24.4 | 22.2 |

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

Ratio Analysis

| Y/E 31 Mar | FY19A | FY20P | FY21E | FY22E | FY23E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 25.0 | 6.5 | (6.2) | 17.7 | 6.2 |
| EBITDA | 13.5 | 18.9 | 0.9 | 14.0 | 2.2 |
| Adjusted EPS | 14.4 | 45.1 | (6.3) | 12.7 | 0.3 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 31.7 | 35.4 | 38.1 | 36.9 | 35.5 |
| EBIT margin | 27.2 | 30.0 | 32.0 | 31.1 | 29.4 |
| Adjusted profit margin | 19.6 | 26.7 | 26.7 | 25.5 | 24.1 |
| Adjusted ROAE | 24.2 | 29.5 | 23.9 | 24.4 | 22.2 |
| ROCE | 22.0 | 26.8 | 21.5 | 22.3 | 20.3 |
| Working capital days (days) | | | | | |
| Receivables | 12 | 10 | 9 | 8 | 9 |
| Inventory | 6 | 5 | 6 | 5 | 5 |
| Payables | 25 | 27 | 22 | 15 | 16 |
| Ratios (x) | | | | | |
| Gross asset turnover | 1.1 | 1.0 | 0.8 | 0.9 | 0.8 |
| Current ratio | 0.7 | 0.4 | 0.8 | 0.7 | 0.5 |
| Net interest coverage ratio | 0.0 | 136.5 | 0.0 | 0.0 | 0.0 |
| Adjusted debt/equity | (0.1) | (0.1) | (0.2) | (0.1) | (0.1) |

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

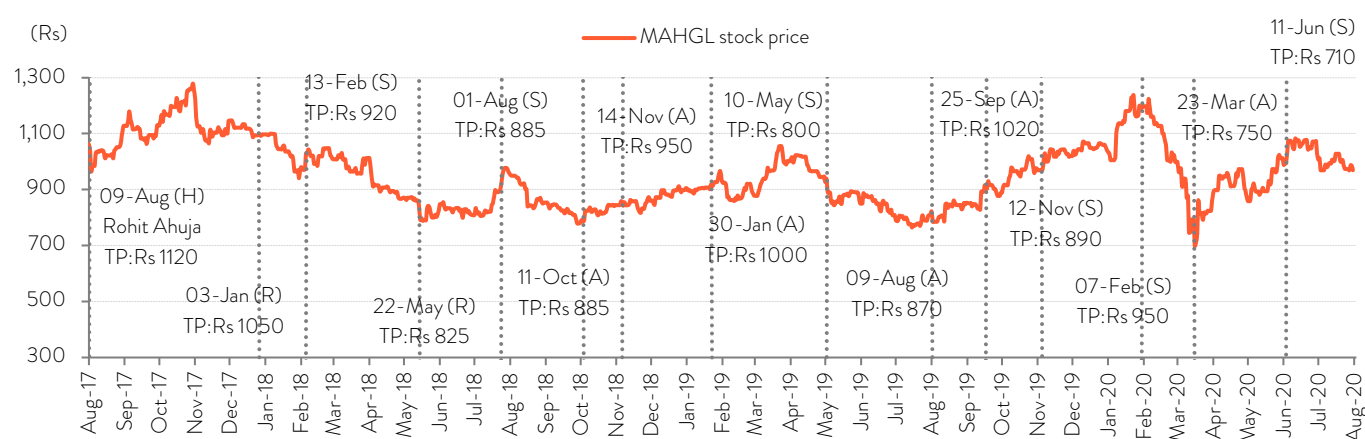
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): MAHANAGAR GAS (MAHGL IN)



B – Buy, A – Add, R – Reduce, S – Sell, H – Hold

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