

SELL

TP: Rs 890 | ▼ 8%

MAHANAGAR GAS

Oil & Gas

12 November 2019

Volumes drag and margins peak out – downgrade to SELL

Mahanagar Gas's (MAHGL) Q2FY20 adj. PAT underperformed estimates at Rs 2.1bn (+57% YoY). Key Q2 highlights: (a) EBITDA margins disappointed at Rs 9.9/scm (-3.3% QoQ) on higher costs, and (b) volumes were muted at 276mmscm (+1.3% YoY). We broadly maintain FY20-FY22 earnings estimates as our volume growth cut (to 3.5% CAGR) is neutralised by lower tax rates. Our Sep'20 DCF-based TP changes to Rs 890 (vs. Rs 1,020) as we assume lower terminal growth (2%). Downgrade to SELL from ADD.

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Muted volume growth: MAHGL's volume growth remained subpar, slowing to 1.3% YoY in Q2 (276mmscm). CNG (203mmscm, +1% YoY) was muted due to a high base and slowdown in the addition or conversion rate of vehicles using this fuel. We believe the downturn in CNG volume growth could continue over the long term given rising infrastructure constraints and improving alternate travel options in Mumbai (metro). We thus cut our volume growth estimates to 3.5% CAGR over FY20-FY22 from 4.5% earlier.

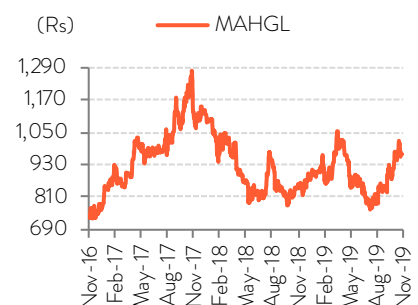
Margins appear to have peaked: EBITDA for Q2 were below estimates at Rs 9.9/scm (-3.3% QoQ). Among GAIL-owned CGD companies, MAHGL has the highest margins but the lowest volume growth. Hence, there is a high probability that the company may be forced to adopt a strategy of chasing volume growth at the expense of margins (like IGL).

Downgrade to SELL: We cut our DCF-based value for MAHGL to Rs 890 (from Rs 1,020) as we lower terminal growth assumptions to 2% (from 5%), driven by concerns over long-term volume growth. Additionally, margins seem to have peaked out and we now estimate EBITDA/scm at ~Rs 10 over FY20-FY22.

Ticker/Price	MAHGL IN/Rs 969
Market cap	US\$ 1.3bn
Shares o/s	99mn
3M ADV	US\$ 9.5mn
52wk high/low	Rs 1,067/Rs 754
Promoter/FPI/DII	33%/29%/39%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	22,330	27,911	33,122	36,170	39,016
EBITDA (Rs mn)	7,801	8,855	11,085	11,590	12,065
Adj. net profit (Rs mn)	4,780	5,467	7,828	8,152	8,450
Adj. EPS (Rs)	48.4	55.3	79.3	82.5	85.5
Adj. EPS growth (%)	21.5	14.4	43.2	4.1	3.7
Adj. ROAE (%)	24.3	24.2	30.4	28.2	26.1
Adj. P/E (x)	20.0	17.5	12.2	11.7	11.3
EV/EBITDA (x)	12.1	10.7	8.4	7.9	7.4

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Net sales	7,836	6,965	12.5	7,575	3.4	15,411	13,288	16.0
Raw material consumed	3,785	3,562	6.2	3,482	8.7	7,267	6,492	11.9
% of sales	48.3	51.1	-	46.0	-	47.2	48.9	-
Other expenditure	1,317	1,188	10.8	1,324	(0.6)	2,641	2,343	12.7
% of sales	16.8	17.1	-	17.5	-	17.1	17.6	-
EBITDA	2,734	2,215	23.5	2,768	(1.2)	5,502	4,453	23.6
EBITDA margin (%)	34.9	31.8	-	36.5	-	35.7	33.5	-
EBITDA (Rs/scm)	9.9	8.1	21.8	10.3	(3.3)	10.1	8.3	20.8
Depreciation and amortization	391	308	27.0	372	5.1	763	603	26.5
Interest	15	1	1108.3	14	5.8	28	2	1,466.7
Other income	230	182	26.5	203	13.0	433	335	29.3
Profit Before Tax	2,558	2,087	22.6	2,586	(1.1)	5,145	4,184	23.0
Provision for tax	(148)	724	(120.4)	884	(116.7)	736	1,408	(47.7)
- Effective tax rate (%)	(5.8)	34.7	-	34.2	-	14.3	33.7	-
Reported PAT	2,706	1,363	98.6	1,573	72.0	4,409	2,776	58.8
Exceptional item (adj-post tax)	564	-	-	-	-	488	-	-
PAT (adjusted)	2,143	1,363	57.2	1,702	25.9	3,921	2,776	41.3
Total income	2,149	1,373	56.5	1,706	26.0	3,939	2,769	42.3
Adj. EPS (Rs)	21.7	13.8	57.2	17.2	25.9	39.6	28.1	40.9

Source: Company, BOBCAPS Research

FIG 2 – VOLUME BREAK-UP

	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
CNG volumes (mmscm)	203	200	1.0	197	2.8	400	394	1.5
PNG volumes (mmscm)	73	72	2.2	73	0.4	147	140	4.5
Industrial/Commercial	38	38	0.2	37	4.6	75	73	2.3
Domestic	35	34	4.5	36	(3.9)	71	67	7.0
Total volumes (mmscm)	276	272	1.3	270	2.2	546	534	2.3
Total volumes (mmscmd)	3.00	2.96	1.3	2.97	1.1	2.98	2.92	2.3

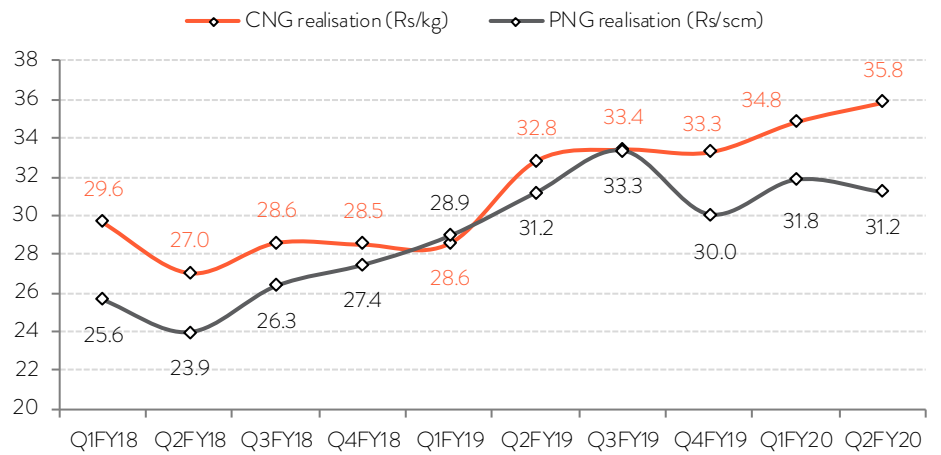
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Avg realisation (Rs/scm)	28.4	25.6	11.0	28.0	1.2	28.2	24.9	13.4
Gas cost (Rs/scm)	13.7	13.1	4.8	12.9	6.4	13.3	12.2	9.4
Gross spreads (Rs/scm)	14.7	12.5	17.5	15.2	(3.1)	14.9	12.7	17.1
CNG realisation (Rs/kg)	35.8	32.8	9.1	34.8	2.9	35.7	29.7	20.0
PNG realisation (Rs/scm)	31.2	31.2	0.1	31.8	(2.0)	31.8	30.1	5.9
EBITDA (Rs/scm)	9.9	8.1	21.8	10.3	(3.3)	10.1	8.3	20.8
Other operating costs (Rs/scm)	4.8	4.4	9.4	4.9	(2.7)	4.8	4.4	10.2

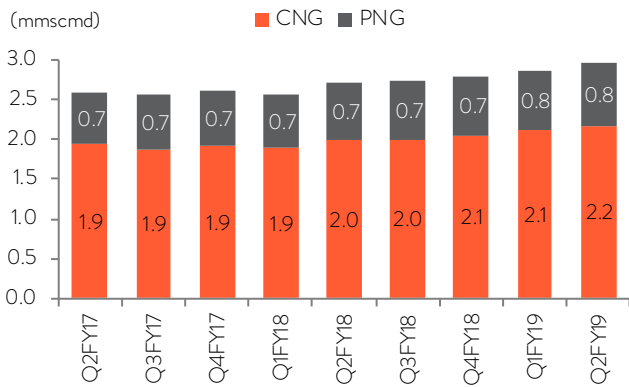
Source: Company, BOBCAPS Research

FIG 4 – CNG AND PNG REALISATIONS



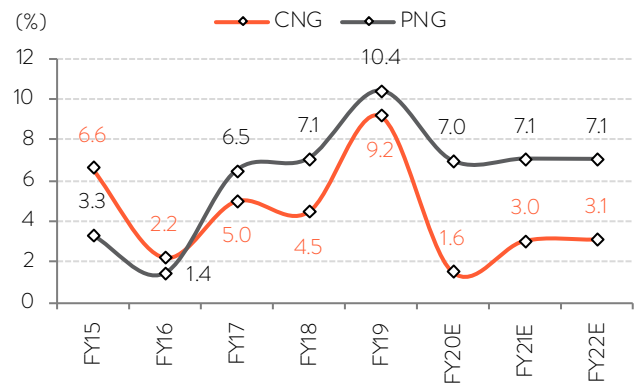
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Valuation methodology

We broadly maintain FY20-FY22 earnings estimates as our volume growth cut (to 3.5% CAGR) is neutralised by lower tax rates. Our Sep'20 DCF-based target price reduces to Rs 890 (vs. Rs 1,020) as we assume lower terminal growth (2% vs. 5% earlier), driven by concerns over long-term volume growth. Additionally, margins seem to have peaked out and we now estimate EBITDA/scm at ~Rs 10/scm (FY20-FY22). Downgrade the stock to SELL from ADD.

FIG 7 – VALUATION SUMMARY

Valuation parameters	(Rs mn)
WACC (%)	9.4
Terminal Year growth (%)	2.0
PV of FCF	23,333
PV of terminal value	53,434
Firm Value	76,766
Less Net Debt	(11,546)
Equity value	88,300
Equity Value (Rs/share)	890

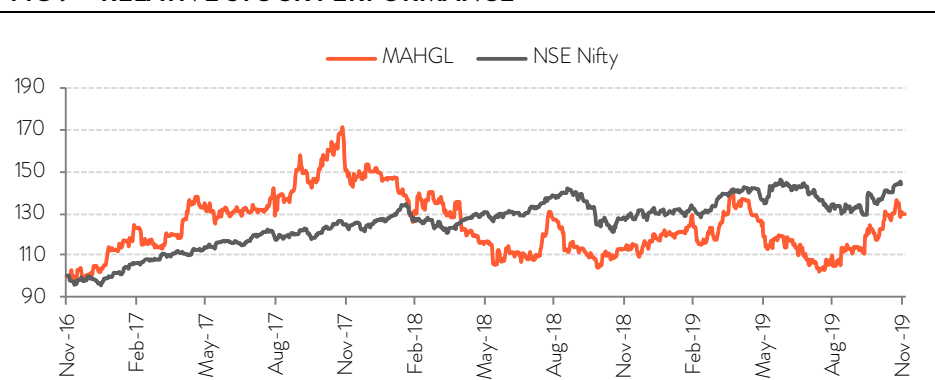
Source: BOBCAPS Research

FIG 8 – SENSITIVITY OF FAIR VALUE TO WACC AND TERMINAL GROWTH

		WACC (%)				
Terminal growth (%)	(Rs)	7.4	8.4	9.4	10.4	11.4
	0		957	857	778	715
1		1,050	925	829	754	693
2		1,177	1,014	890	803	731
3		1,363	1,136	979	865	778
4		1,659	1,314	1,097	947	837

Source: BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our estimates are:

- Higher than expected operating margins,
- Higher-than-estimated volume growth for CNG and PNG, and
- Faster-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	FY19A	FY20E	FY21E	FY22E
Total revenue	22,330	27,911	33,122	36,170	39,016
EBITDA	7,801	8,855	11,085	11,590	12,065
Depreciation	(1,112)	(1,259)	(1,468)	(1,633)	(1,809)
EBIT	6,689	7,595	9,617	9,958	10,256
Other income/(expenses)	577	777	835	926	1,025
EBT	7,266	8,372	10,452	10,884	11,281
Income taxes	(2,486)	(2,905)	(2,623)	(2,732)	(2,832)
Reported net profit	4,780	5,467	7,828	8,152	8,450
Adjusted net profit	4,780	5,467	7,828	8,152	8,450

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	1,100	1,524	1,296	1,456	1,597
Other current liabilities	6,081	5,179	6,038	6,734	7,384
Provisions	207	212	720	750	778
Debt funds	12	11	10	9	8
Other liabilities	1,748	2,039	2,573	3,128	3,703
Equity capital	988	988	988	988	988
Reserves & surplus	19,966	23,199	26,249	29,631	33,137
Shareholders' fund	20,953	24,187	27,237	30,619	34,125
Total liabilities and equities	30,102	33,152	37,873	42,696	47,594
Cash and cash eq.	919	2,988	4,320	5,924	8,064
Accounts receivables	916	995	1,270	1,387	1,496
Inventories	240	191	272	297	321
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	37,873	42,696	47,595

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	5,891	6,726	9,296	9,785	10,259
Changes in working capital	581	804	782	745	686
Other operating cash flows	(208)	(486)	(302)	(371)	(450)
Cash flow from operations	6,264	7,044	9,777	10,158	10,494
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)	(3,199)	(4,580)	(4,770)	(4,944)
Other financing cash flows	706	1,742	637	926	1,025
Cash flow from financing	(1,662)	(1,458)	(3,945)	(3,845)	(3,919)
Changes in cash and cash eq.	(442)	2,069	1,332	1,604	2,140
Closing cash and cash eq.	919	2,988	4,320	5,924	8,064

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	48.4	55.3	79.3	82.5	85.5
Adjusted EPS	48.4	55.3	79.3	82.5	85.5
Dividend per share	19.0	27.7	39.6	41.3	42.8
Book value per share	212.1	244.9	275.7	310.0	345.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	4.2	3.4	2.8	2.5	2.3
EV/EBITDA	12.1	10.7	8.4	7.9	7.4
Adjusted P/E	20.0	17.5	12.2	11.7	11.3
P/BV	4.6	4.0	3.5	3.1	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	65.8	65.3	74.9	74.9	74.9
Interest burden (PBT/EBIT)	108.6	110.2	108.7	109.3	110.0
EBIT margin (EBIT/Revenue)	30.0	27.2	29.0	27.5	26.3
Asset turnover (Revenue/Avg TA)	79.3	88.2	93.3	89.8	86.4
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.4
Adjusted ROAE	24.3	24.2	30.4	28.2	26.1

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	9.8	25.0	18.7	9.2	7.9
EBITDA	21.1	13.5	25.2	4.6	4.1
Adjusted EPS	21.5	14.4	43.2	4.1	3.7
Profitability & Return ratios (%)					
EBITDA margin	34.9	31.7	33.5	32.0	30.9
EBIT margin	30.0	27.2	29.0	27.5	26.3
Adjusted profit margin	21.4	19.6	23.6	22.5	21.7
Adjusted ROAE	24.3	24.2	30.4	28.2	26.1
ROCE	22.3	22.0	28.0	25.8	23.7
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	1.0	1.1
Net interest coverage ratio	0.0	0.0	0.0	0.0	0.0
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%

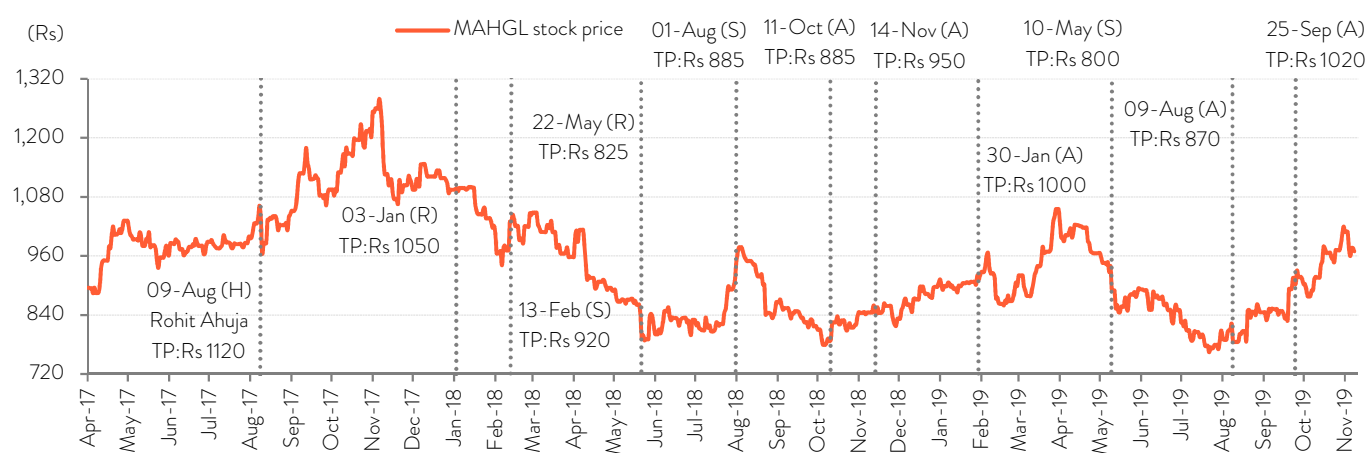
ADD – Expected return from >+5% to +15%

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)



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

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