

SELL

TP: Rs 950 | ▼ 21%

MAHANAGAR GAS

Oil & Gas

07 February 2020

Volumes drag and margins peak out

Mahanagar Gas's (MAHGL) Q3FY20 PAT was in line at Rs 1.86bn (+25.4% YoY). Key Q3 highlights: (a) EBITDA margins disappointed at Rs 9.2/scm (-7% QoQ) on higher costs, and (b) volumes were muted at 281mmscm (+3% YoY). MAHGL lags its peers on volume growth, while its elevated operating margins appear to have peaked out. We marginally trim FY20-FY22 earnings as we cut operating margin estimates to Rs 9.6/scm (from Rs 10), on par with 9MFY20 levels. Our DCF-based TP changes to Rs 950 (vs. Rs 890) on rollover.

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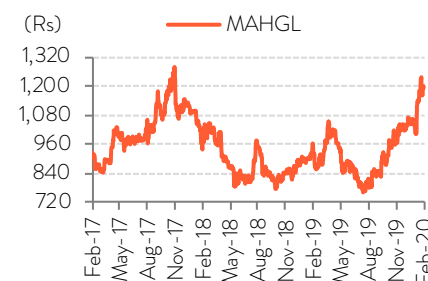
Muted volume growth: MAHGL's volume growth continues to be subpar when compared to its CGD peers, at 3% YoY in Q3 (281mmscm). CNG growth (205mmscm, +2.4% YoY) was muted due to a high base and slowdown in the addition or conversion rate of vehicles using this fuel. The downturn in CNG volume growth could continue over the long term given rising infrastructure constraints and improving alternate travel options in Mumbai (metro). We maintain volume growth estimates at 3.5% CAGR over FY20-FY22, lagging peers (Indraprastha Gas and Gujarat Gas) that offer >10% CAGR.

Ticker/Price	MAHGL IN/Rs 1,199
Market cap	US\$ 1.7bn
Shares o/s	99mn
3M ADV	US\$ 13.4mn
52wk high/low	Rs 1,246/Rs 754
Promoter/FPI/DII	33%/32%/36%

Source: NSE

Margins have peaked – as expected: EBITDA margins for Q3 were below estimates at Rs 9.2/scm (-7% QoQ). Among GAIL-owned CGD companies, MAHGL continues to have one of the highest operating margins, but one of the lowest volume growth rates. We see a high probability for margins to decline further as the company could choose to chase volumes.

STOCK PERFORMANCE



Source: NSE

Maintain SELL: We raise our DCF-based TP for MAHGL to Rs 950 on rollover to Mar'21. At 14.3x FY22E EPS, the stock continues to attract among the lowest multiples, but valuations look justified on stagnant earnings growth. Margins have peaked out and we now estimate EBITDA/scm at ~Rs 9.6 (FY20-FY22).

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	22,330	27,911	33,250	36,329	39,201
EBITDA (Rs mn)	7,801	8,855	10,880	11,382	11,852
Adj. net profit (Rs mn)	4,780	5,467	8,194	8,007	8,298
Adj. EPS (Rs)	48.4	55.3	83.0	81.1	84.0
Adj. EPS growth (%)	21.5	14.4	49.9	(2.3)	3.6
Adj. ROAE (%)	24.3	24.2	31.8	27.6	25.6
Adj. P/E (x)	24.8	21.7	14.4	14.8	14.3
EV/EBITDA (x)	15.0	13.2	10.7	10.1	9.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19A	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Net sales	7,445	7,527	(1.1)	7,836	(5.0)	22,856	20,685	10.5
Raw material consumed	3,543	3,835	(7.6)	3,785	(6.4)	10,810	10,326	4.7
% of sales	47.6	50.9	-	48.3	-	47.3	49.9	-
Other expenditure	1,313	1,301	0.9	1,317	(0.3)	3,955	3,644	8.5
% of sales	17.6	17.3	-	16.8	-	17.3	17.6	-
EBITDA	2,589	2,391	8.3	2,734	(5.3)	8,091	6,715	20.5
EBITDA margin (%)	34.8	31.8	-	34.9	-	35.4	32.5	-
EBITDA (Rs/scm)	9.2	8.8	5.1	9.9	(7.0)	9.8	8.3	17.5
Depreciation and amortization	415	328	26.5	391	6.0	1,177	931	26.5
Interest	16	1	1700.0	15	11.7	44	3	1,544.4
Other income	286	204	40.2	230	24.3	719	539	33.4
Profit Before Tax	2,444	2,266	7.8	2,558	(4.5)	7,588	6,321	20.1
Provision for tax	583	783	(25.5)	(148)	(494.5)	1,319	2,191	(39.8)
- Effective tax rate (%)	23.9	34.6	-	(5.8)	-	17.4	34.7	-
Reported PAT	1,861	1,483	25.4	2,577	(27.8)	6,269	4,129	51.8
Total income	1,867	1,493	25.0	2,691	(30.6)	6,288	4,123	52.5
Reported EPS (Rs)	18.8	15.0	25.4	27.4	(31.3)	63.3	41.8	51.5

Source: Company, BOBCAPS Research

FIG 2 – VOLUME BREAK-UP

	Q3FY20	Q3FY19A	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
CNG volumes (mmscm)	205	200	2.4	203	1.0	604	593	1.8
PNG volumes (mmscm)	76	73	4.8	73	3.7	223	213	4.6
Industrial/Commercial	38	37	3.0	38	(0.3)	113	111	2.5
Domestic	38	36	6.6	35	8.2	109	102	6.8
Total volumes (mmscm)	281	273	3.0	276	1.8	827	806	2.6
Total volumes (mmscmd)	3.05	2.96	3.0	3.00	1.8	3.01	2.93	2.6

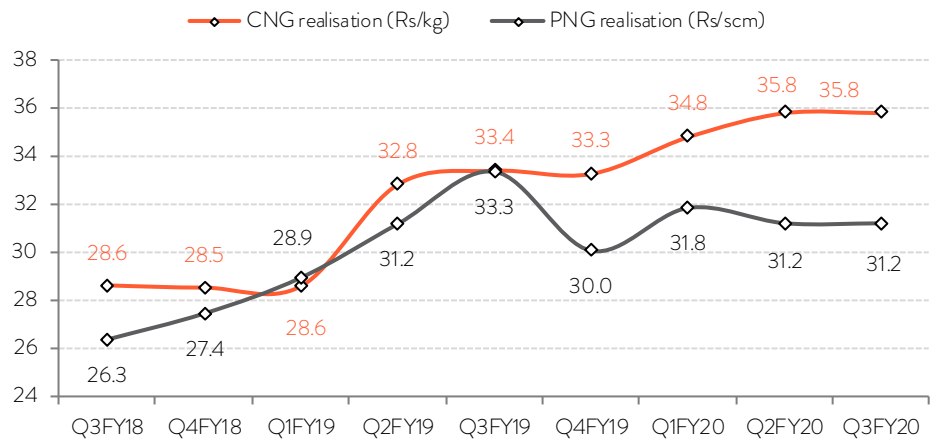
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

	Q3FY20	Q3FY19A	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Avg realisation (Rs/scm)	26.5	27.6	(4.0)	28.4	(6.6)	27.6	25.7	7.7
Gas cost (Rs/scm)	12.6	14.1	(10.3)	13.7	(8.0)	13.1	12.8	2.1
Gross spreads (Rs/scm)	13.9	13.5	2.6	14.7	(5.3)	14.6	12.8	13.4
CNG realisation (Rs/kg)	35.8	33.4	7.2	35.8	-	35.5	31.0	14.6
PNG realisation (Rs/scm)	31.2	33.3	(6.5)	31.2	-	31.4	31.2	0.7
EBITDA (Rs/scm)	9.2	8.8	5.1	9.9	(7.0)	9.8	8.3	17.5
Other operating costs (Rs/scm)	4.7	4.8	(2.0)	4.8	(2.0)	4.8	4.5	5.8

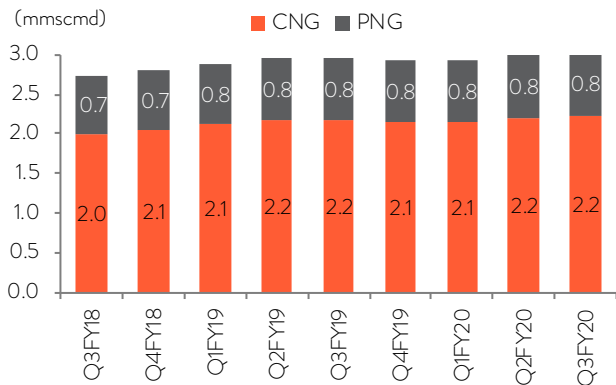
Source: Company, BOBCAPS Research

FIG 4 – CNG AND PNG REALISATIONS



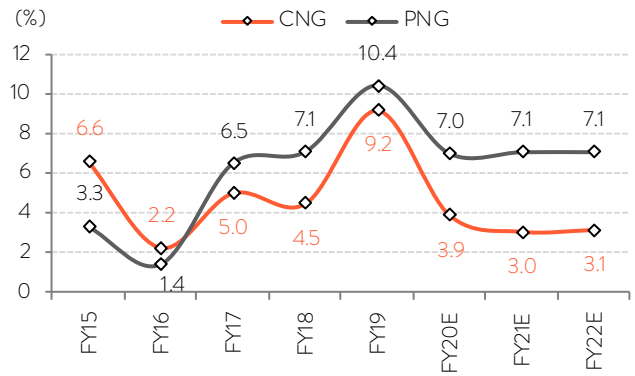
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Valuation methodology

We marginally trim FY20-FY22 earnings on reduced operating margin estimates of Rs 9.6/scm for MAHGL (from Rs 10), at par with 9MFY20 levels. Rolling valuations forward, we move to a revised Mar'21 DCF-based TP of Rs 950 (from Rs 890). At 14.3x FY22E EPS, the stock continues to attract among the lowest multiples, but valuations look justified given stagnant earnings growth. Maintain SELL.

FIG 7 – VALUATION SUMMARY

Valuation parameters	(Rs mn)
WACC (%)	8.8
Terminal Year growth (%)	2.0
PV of FCF	22,511
PV of terminal value	53,434
Firm Value	82,084
Less Net Debt	(11,758)
Equity value	93,842
Equity Value (Rs/share)	950

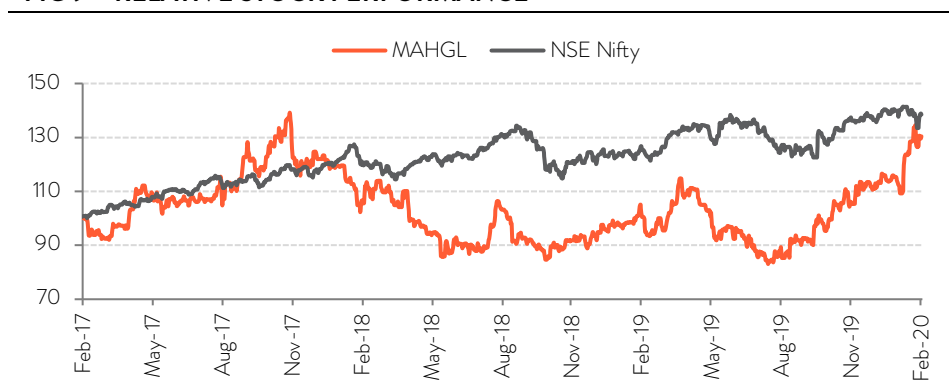
Source: BOBCAPS Research

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

		WACC (%)					
		(Rs)	6.8	7.8	8.8	9.8	10.8
Terminal growth (%)	0		1,009	899	814	745	689
	1		1,121	979	873	791	725
	2		1,278	1,086	950	848	769
	3		1,518	1,238	1,054	923	825
	4		1,927	1,469	1,200	1,022	896

Source: BOBCAPS Research

FIG 9 – 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 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	33,250	36,329	39,201
EBITDA	7,801	8,855	10,880	11,382	11,852
Depreciation	(1,112)	(1,259)	(1,468)	(1,633)	(1,809)
EBIT	6,689	7,595	9,412	9,749	10,044
Other income/(expenses)	577	777	843	940	1,035
EBT	7,266	8,372	10,255	10,690	11,079
Income taxes	(2,486)	(2,905)	(2,061)	(2,683)	(2,781)
Reported net profit	4,780	5,467	8,194	8,007	8,298
Adjusted net profit	4,780	5,467	8,194	8,007	8,298

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	1,100	1,524	1,316	1,478	1,621
Other current liabilities	6,081	5,179	6,129	6,835	7,493
Provisions	207	212	686	737	764
Debt funds	12	11	10	9	8
Other liabilities	1,748	2,039	2,562	3,108	3,673
Equity capital	988	988	988	988	988
Reserves & surplus	19,966	23,199	26,400	29,722	33,165
Shareholders' fund	20,953	24,187	27,388	30,710	34,153
Total liabilities and equities	30,102	33,152	38,091	42,876	47,711
Cash and cash eq.	919	2,988	4,532	6,097	8,172
Accounts receivables	916	995	1,275	1,393	1,504
Inventories	240	191	273	299	322
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	38,091	42,877	47,711

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	5,891	6,726	9,662	9,639	10,107
Changes in working capital	581	804	853	776	694
Other operating cash flows	(208)	(486)	(320)	(395)	(470)
Cash flow from operations	6,264	7,044	10,194	10,020	10,331
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)	(4,794)	(4,685)	(4,855)
Other financing cash flows	706	1,742	645	940	1,035
Cash flow from financing	(1,662)	(1,458)	(4,150)	(3,745)	(3,821)
Changes in cash and cash eq.	(442)	2,069	1,544	1,565	2,075
Closing cash and cash eq.	919	2,988	4,532	6,097	8,172

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	48.4	55.3	83.0	81.1	84.0
Adjusted EPS	48.4	55.3	83.0	81.1	84.0
Dividend per share	19.0	27.7	41.5	40.5	42.0
Book value per share	212.1	244.9	277.3	310.9	345.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	5.2	4.2	3.5	3.2	2.9
EV/EBITDA	15.0	13.2	10.7	10.1	9.5
Adjusted P/E	24.8	21.7	14.4	14.8	14.3
P/BV	5.6	4.9	4.3	3.9	3.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	65.8	65.3	79.9	74.9	74.9
Interest burden (PBT/EBIT)	108.6	110.2	109.0	109.6	110.3
EBIT margin (EBIT/Revenue)	30.0	27.2	28.3	26.8	25.6
Asset turnover (Revenue/Avg TA)	79.3	88.2	93.3	89.7	86.5
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.4
Adjusted ROAE	24.3	24.2	31.8	27.6	25.6

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	19.1	9.3	7.9
EBITDA	21.1	13.5	22.9	4.6	4.1
Adjusted EPS	21.5	14.4	49.9	(2.3)	3.6
Profitability & Return ratios (%)					
EBITDA margin	34.9	31.7	32.7	31.3	30.2
EBIT margin	30.0	27.2	28.3	26.8	25.6
Adjusted profit margin	21.4	19.6	24.6	22.0	21.2
Adjusted ROAE	24.3	24.2	31.8	27.6	25.6
ROCE	22.3	22.0	29.2	25.1	23.2
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	0.9	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%

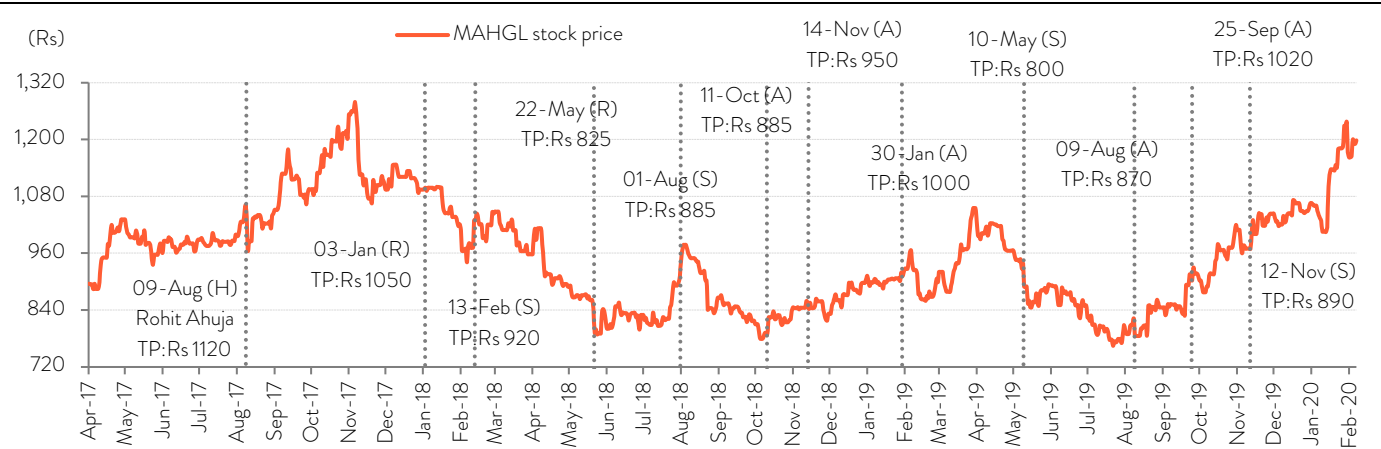
ADD – Expected return from >+5% to +15%

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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