

SELL

TP: Rs 710 | ▼ 31%

MAHANAGAR GAS

Oil & Gas

11 June 2020

Margins expand but volume outlook weak – cut to SELL

Mahanagar Gas's (MAHGL) Q4FY20 PAT underperformed at Rs 1.7bn (+25% YoY). Q4 highlights: (a) EBITDA margins improved to Rs 9.6/scm (+4% QoQ) on low spot LNG prices, and (b) volumes disappointed at 253mmscm (-6.3% YoY). Concerns over MAHGL's volume growth have been aggravated by the pandemic, and its high CNG dependence would delay revival. We raise margin estimates for FY21 but trim earnings by 7% on staggered volume recovery. Our Mar'21 TP changes to Rs 710 (vs. Rs 750). Downgrade from ADD to SELL.

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Volumes dip on lockdown: CNG volumes declined 9% YoY to 180mmscm as a fallout of the nationwide lockdown in Mar'20, translating into a ~1% decline for FY20. This aggravates concerns for MAHGL's overall volume trend in FY21 (CNG being 73% of the FY20 mix), implying recovery may be delayed well beyond H1FY21. In fact, sluggish CNG volume growth could continue over the longer term given rising infrastructure constraints and improving alternate travel options (metro) in Mumbai. We therefore prune volume growth estimates to 0.2% in FY21 (from 5% earlier).

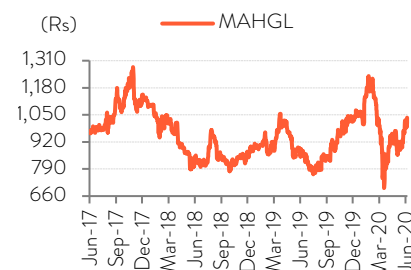
Margins improve but may remain muted on sluggish volumes: Q4 EBITDA was muted at Rs 2.4bn (-6% QoQ) despite higher margins of Rs 9.6/scm (+4.4% QoQ). Although gas prices have declined, margins may be under pressure considering the steep 60% YoY drop-off in volumes expected in Q1FY21 (especially for high-margin CNG). As volumes take longer to revive, MAHGL may not be able to cash in on lower gas costs.

Downgrade to SELL: Muted FY20-FY22 earnings trends accompanied by recurring concerns over CNG volume growth are likely to induce a multiple derating. Expansion into new areas could also be delayed due to the pandemic impact. Downgrade from ADD to SELL.

Ticker/Price	MAHGL IN/Rs 1,036
Market cap	US\$ 1.4bn
Shares o/s	99mn
3M ADV	US\$ 10.5mn
52wk high/low	Rs 1,246/Rs 664
Promoter/FPI/DII	33%/31%/36%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	22,330	27,911	29,721	27,877	32,819
EBITDA (Rs mn)	7,801	8,855	10,528	10,626	12,112
Adj. net profit (Rs mn)	4,780	5,467	7,935	7,437	8,381
Adj. EPS (Rs)	48.4	55.3	80.3	75.3	84.8
Adj. EPS growth (%)	21.5	14.4	45.1	(6.3)	12.7
Adj. ROAE (%)	24.3	24.2	29.5	23.9	24.4
Adj. P/E (x)	21.4	18.7	12.9	13.8	12.2
EV/EBITDA (x)	12.9	11.4	9.5	9.4	8.1

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

Y/E March (Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Net sales	6,866	7,225	(5.0)	7,445	(7.8)	29,721	27,911	6.5
Raw Material Consumed	2,985	3,665	(18.6)	3,543	(15.7)	13,795	13,992	(1.4)
% of sales	43.5	50.7	-	47.6	-	46.4	50.1	-
Other expenditure	1,442	1,421	1.5	1,313	9.8	5,398	5,065	6.6
% of sales	21.0	19.7	-	17.6	-	18.2	18.1	-
EBITDA	2,438	2,140	14.0	2,589	(5.8)	10,528	8,855	18.9
EBITDA margin (%)	35.5	29.6	-	34.8	-	35.4	31.7	-
EBITDA (Rs/scm)	9.6	7.9	21.7	9.2	4.4	9.7	8.2	18.5
Depn and amortization	440	329	33.8	415	6.1	1,617	1,259	28.4
Interest	21	1	4,060.0	16	28.4	65	3	1,937.5
Other income	270	238	13.1	286	(5.6)	990	777	27.3
Profit Before Tax	2,247	2,049	9.7	2,444	(8.0)	9,835	8,369	17.5
Provision for tax	581	714	(18.6)	583	(0.3)	1,900	2,905	(34.6)
-effective tax rate (%)	25.9	34.9	-	23.9	-	19.3	34.7	-
PAT (reported)	1,666	1,335	24.8	1,731	(3.8)	7,935	5,464	45.2
Total income	1,672	1,335	25.3	1,851	(9.7)	7,953	5,457	45.7
Reported EPS (Rs)	16.9	13.5	24.8	17.5	(3.8)	80.3	55.3	45.2

Source: Company, BOBCAPS Research

FIG 2 – VOLUME BREAK-UP

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
CNG Volumes (mmscm)	180	198	(8.8)	205	(12.0)	784	791	(0.8)
PNG Volumes (mmscm)	73	73	0.4	76	(3.8)	296	286	3.5
Industrial/Commercial	35	38	(7.0)	38	(8.3)	148	148	(0.5)
Domestic	38	35	8.4	38	0.7	148	138	7.9
Total Volumes (mmscm)	253	270	(6.3)	281	(9.8)	1,080	1,077	0.3
Total Volumes (mmscmd)	2.82	3.01	(6.3)	3.05	(7.8)	2.95	2.95	0.0

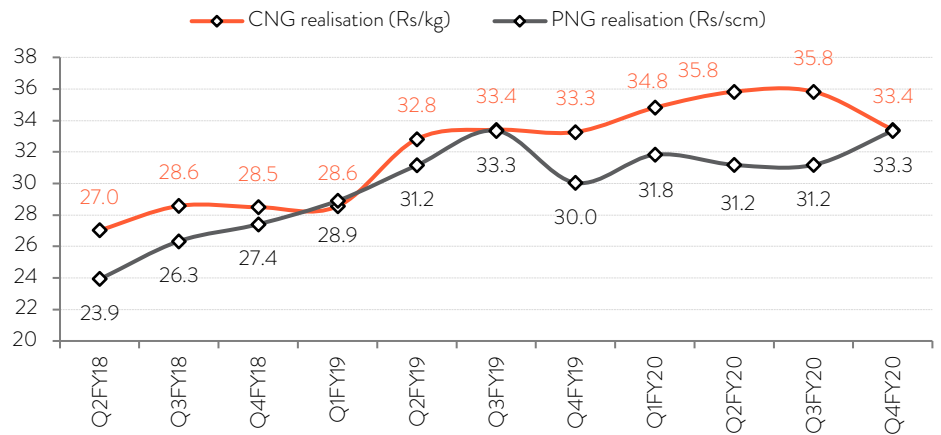
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Avg realisation (Rs/scm)	27.1	26.7	1.4	26.5	2.2	27.5	25.9	6.1
Gas cost (Rs/scm)	11.8	13.6	(13.1)	12.6	(6.6)	12.8	13.0	(1.7)
Gross Spreads (Rs/scm)	15.3	13.2	16.3	13.9	10.2	14.7	12.9	14.0
CNG Realization (Rs/kg)	33.4	33.3	0.4	35.8	(6.8)	34.5	32.0	7.7
PNG Realization (Rs/scm)	33.3	30.0	11.0	31.2	6.9	30.2	30.9	(2.2)
EBITDA (Rs/scm)	9.6	7.9	21.7	9.2	4.4	9.7	8.2	18.5
Other operating costs (Rs/scm)	5.7	5.3	8.3	4.7	21.7	5.0	4.7	6.2

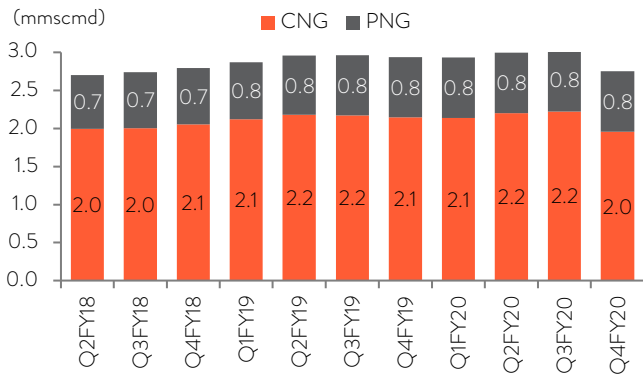
Source: Company, BOBCAPS Research

FIG 4 – CNG AND PNG REALISATIONS



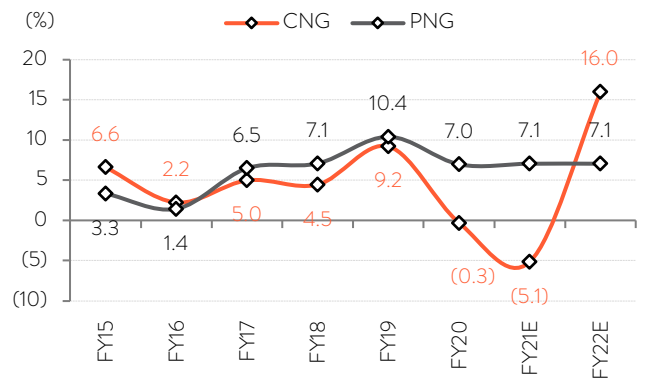
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Earnings call highlights

- Management expects CNG volumes to bounce back during the current phase of lockdown easing, recovering faster than commercial volumes. During April and May, CNG was at 25% and 42% of normal sale volumes respectively. June is expected to be progressively better.
- Margins in the commercial and industrial segments stood at Rs 36/scm and Rs 29/scm respectively during Q4FY20. Current margins are slightly lower.
- The quarter had unsold inventory of 25-30mmscm due to the lockdown imposed in the last week of March.
- MAHGL added 1.26mn households and 24 industrial customers during the quarter.
- 220 of the company's 256 CNG stations are currently operational. Management expects to add ~15 stations during FY21.
- Infrastructure and capex plans have not yet been affected by the Covid-19 crisis, though management expects more day-to-day operational-level hindrances such as society permissions for meter readings and low labour availability.
- No regulations are currently in place for MAHGL's exclusivity period in Mumbai which ended in March this year, and the matter is currently sub judice. However, management does not expect any material or adverse impact to arise out of this issue.
- The Raigad market has a clear preference for CNG. Pre-Covid volumes stood at 38,000kg/day (~0.052mmscmd). At present, the company has 5,200 domestic connections and 28 CNG stations in Raigad.
- Annual capex for FY21 is planned at Rs 4.5bn-5bn, and would trend higher than these levels from FY22. For FY20, capex was at Rs 4.2bn (of which Rs 0.6bn was spent on CNG stations and the rest on pipelines).

Valuation methodology

Concerns over MAHGL's volume growth have been aggravated by the Covid-19 crisis, and the company's high dependence on CNG would further delay revival. Expansion into new areas is also likely to be hindered by the pandemic. We raise operating margin estimates for FY21 to Rs 9.7/scm but trim earnings by 7% assuming staggered volume recovery.

Our Mar'21 DCF-based target price reduces to Rs 710 (vs. Rs 750). Muted FY20-FY22 earnings trends accompanied by recurring concerns over CNG volume growth are likely to induce a multiple derating. Downgrade from ADD to SELL.

FIG 7 – REVISED ESTIMATES

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

Source: Company, BOBCAPS Research

FIG 8 – VALUATION SUMMARY

Valuation parameters	(Rs mn)
WACC (%)	9.9
Terminal Year growth (%)	2.0
PV of FCF	15,792
PV of terminal value	40,687
Firm Value	56,479
Less Net Debt	(13,553)
Equity value	70,032
Equity Value (Rs/share)	710

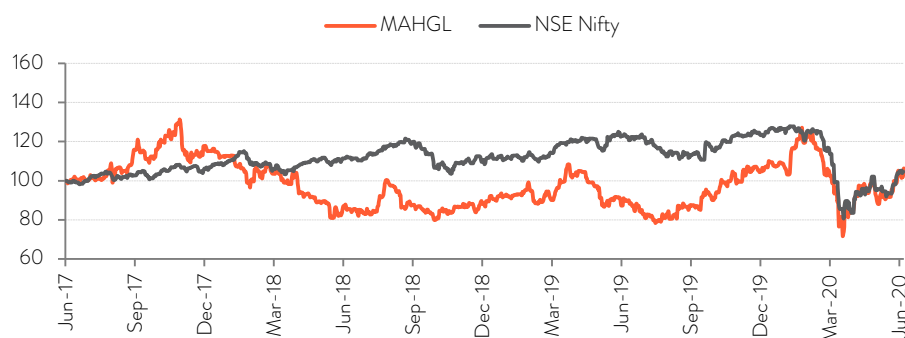
Source: BOBCAPS Research

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

		WACC (%)				
		(Rs)	7.9	8.9	9.9	10.9
Terminal growth (%)	0	750	681	626	581	544
	1	815	730	663	610	567
	2	901	792	710	646	595
	3	1,022	875	770	691	630
	4	1,206	992	850	749	673

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 winning bids in the upcoming CGD bidding rounds to be announced by PNGRB.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	22,330	27,911	29,721	27,877	32,819
EBITDA	7,801	8,855	10,528	10,626	12,112
Depreciation	(1,112)	(1,259)	(1,617)	(1,700)	(1,902)
EBIT	6,689	7,595	8,911	8,925	10,210
Net interest income/(expenses)	0	0	(65)	0	0
Other income/(expenses)	577	777	990	1,004	980
EBT	7,266	8,372	9,835	9,930	11,189
Income taxes	(2,486)	(2,905)	(1,900)	(2,492)	(2,809)
Reported net profit	4,780	5,467	7,935	7,437	8,381
Adjusted net profit	4,780	5,467	7,935	7,437	8,381

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	1,100	1,524	1,318	756	918
Other current liabilities	6,081	5,179	8,571	7,562	9,077
Provisions	207	212	263	274	308
Debt funds	12	11	0	0	0
Other liabilities	1,748	2,039	1,607	2,113	2,684
Equity capital	988	988	988	988	988
Reserves & surplus	19,966	23,199	28,539	31,625	35,102
Shareholders' fund	20,953	24,187	29,527	32,612	36,090
Total liabilities and equities	30,102	33,152	41,285	43,318	49,077
Cash and cash eq.	919	2,988	2,295	5,058	4,570
Accounts receivables	916	995	685	687	809
Inventories	240	191	186	153	180
Other current assets	2,266	958	1,268	1,268	1,268
Investments	6,877	6,736	11,495	8,495	10,495
Net fixed assets	15,319	17,588	20,446	22,205	24,924
CWIP	3,566	3,697	4,865	5,406	6,784
Total assets	30,102	33,153	41,239	43,271	49,030

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	5,891	6,726	9,552	9,138	10,283
Changes in working capital	581	804	3,242	(1,530)	1,562
Other operating cash flows	(208)	(486)	(1,420)	(498)	(409)
Cash flow from operations	6,264	7,044	11,374	7,110	11,437
Capital expenditures	(2,835)	(3,658)	(5,644)	(4,000)	(6,000)
Change in investments	(2,210)	141	(4,759)	3,000	(2,000)
Cash flow from investing	(5,045)	(3,517)	(10,403)	(1,000)	(8,000)
Debt raised/repaid	(15)	(1)	(11)	0	0
Dividends paid	(2,353)	(3,199)	(4,643)	(4,352)	(4,904)
Other financing cash flows	706	1,742	3,037	1,004	980
Cash flow from financing	(1,662)	(1,458)	(1,616)	(3,347)	(3,924)
Changes in cash and cash eq.	(442)	2,069	(645)	2,763	(487)
Closing cash and cash eq.	919	2,988	2,344	5,058	4,570

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	48.4	55.3	80.3	75.3	84.8
Adjusted EPS	48.4	55.3	80.3	75.3	84.8
Dividend per share	19.0	27.7	40.2	37.6	42.4
Book value per share	212.1	244.9	298.9	330.2	365.4

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	4.5	3.6	3.4	3.6	3.0
EV/EBITDA	12.9	11.4	9.5	9.4	8.1
Adjusted P/E	21.4	18.7	12.9	13.8	12.2
P/BV	4.9	4.2	3.5	3.1	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	65.8	65.3	80.7	74.9	74.9
Interest burden (PBT/EBIT)	108.6	110.2	110.4	111.3	109.6
EBIT margin (EBIT/Revenue)	30.0	27.2	30.0	32.0	31.1
Asset turnover (Revenue/Avg TA)	79.3	88.2	79.9	66.0	71.1
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.3
Adjusted ROAE	24.3	24.2	29.5	23.9	24.4

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	9.8	25.0	6.5	(6.2)	17.7
EBITDA	21.1	13.5	18.9	0.9	14.0
Adjusted EPS	21.5	14.4	45.1	(6.3)	12.7
Profitability & Return ratios (%)					
EBITDA margin	34.9	31.7	35.4	38.1	36.9
EBIT margin	30.0	27.2	30.0	32.0	31.1
Adjusted profit margin	21.4	19.6	26.7	26.7	25.5
Adjusted ROAE	24.3	24.2	29.5	23.9	24.4
ROCE	22.3	22.0	26.8	21.5	22.3
Working capital days (days)					
Receivables	15	12	10	9	8
Inventory	8	6	5	6	5
Payables	29	25	27	22	15
Ratios (x)					
Gross asset turnover	1.0	1.1	1.0	0.8	0.9
Current ratio	0.6	0.7	0.4	0.8	0.7
Net interest coverage ratio	0.0	0.0	136.5	0.0	0.0
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.1)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

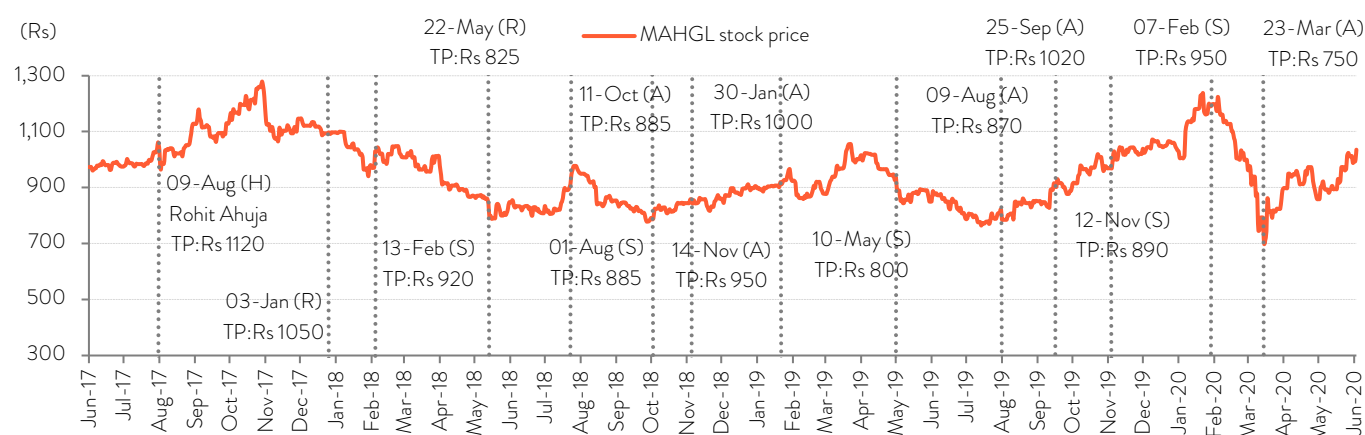
ADD – Expected return from >+5% to +15%

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)

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



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

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