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Stock Update

Mahanagar Gas Limited

Cheapest CGD stock; earnings to bounce back on volume recovery

Oil & Gas	Sharekhan code: MGL	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 968**	
Price Target: **1,380**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

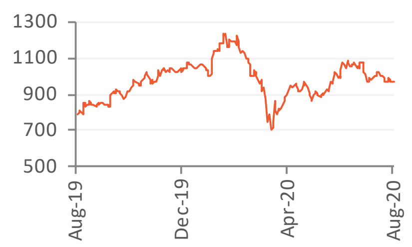
Company details

Market cap:	Rs. 9,559 cr
52-week high/low:	Rs. 1,247/666
NSE volume: (No of shares)	9.2 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	29.9
DII	18.7
Others	18.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.2	7.4	-17.6	23.2
Relative to Sensex	-4.2	-13.5	-10.2	19.9

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on MGL with unchanged PT of Rs. 1,380 given attractive valuation of 11.3x FY22E EPS and potential earnings recovery in FY2022E as volumes and margin would normalise with easing down of lockdown.
- Q1FY21 operating profit of Rs. 80 crore (down 71% y-o-y) substantially lagged estimates due to weaker-than-expected gas sales volume of 1.1 mmscmd (down 62.5% y-o-y) and margin of Rs. 7.9/scm (down 23% y-o-y).
- Earnings to recover sharply over FY22E-FY23E as gas sales volumes likely to normalise (recovered to 65% of pre-COVID-19 level vs. 38% in Q1FY21) and margins rise (low gas cost, better operating leverage and high CNG mix).
- Cheapest CGD stock with attractive valuation of 11.3x FY22E EPS (discount of 28% to its historical PE and 49% to IGL). Valuation gap with peers to narrow on expected revival in volumes, superior margin and FCF yield of 7%.

Mahanagar Gas Limited's (MGL's) Q1FY2021 operating profit of Rs. 80 crore (down 71% y-o-y; down 67% q-o-q) substantially lagged our estimates due to lower-than-expected gas sales volumes of 1.1 mmscmd (down 62.5% y-o-y; down 60% q-o-q) and weak EBITDA margin of Rs. 7.9/scm (down 23% y-o-y; down 17.9% q-o-q). CNG volumes declined sharply by 78% y-o-y to 0.5 mmscmd and PNG volumes were down by 21% y-o-y to 0.6 mmscmd due to a nationwide lockdown amid COVID-19. Gross margin increased by 6.1% y-o-y and 5% q-o-q to Rs. 16.1/scm due to benefit of lower gas cost but EBITDA margin was hit by a sharp rise in per unit operating expenses by 44% q-o-q to Rs. 8.2/scm given volume de-growth. PAT also declined sharply by 73.4% y-o-y and 72.8% q-o-q to Rs. 45 crore, below our estimate of Rs. 55 crore due to weaker-than-expected operating performance partially offset by higher-than-expected other income (up 21% y-o-y). We expect MGL's earnings to recover sharply over FY2022E-FY2023E given likely improvement in gas sales volume (already recovered to 65% of pre-COVID-19 level in August 2020 versus ~38% in Q1FY2021) and higher EBITDA margin with better operating leverage, recent CNG price hike (to recover fixed cost) and improvement in CNG mix in overall volumes. CNG volumes have improved to 50% of pre-COVID-19 levels in August versus only 22% in Q1FY2021. Moreover, MGL is cheapest CGD stock with attractive valuation of 11.3x FY2022E EPS, which is at a steep 28% discount to its historical average one-year forward PE multiple of 15.7x and 49% to that of IGL on a FY2022E PE basis. We expect the valuation gap with peers to narrow given our expectation of revival in volumes, superior margin and return ratios (RoE of ~24%), FCF/dividend yield of 7%/4%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.

Key Positives

- Improvement in gross margin by 6% y-o-y to Rs. 16.1/scm in Q1FY2021 due to lower gas costs.
- Domestic PNG volume grew by 7% y-o-y to 0.4 mmscmd.

Key Negatives

- Lower-than-expected gas sales volume of 1.1 mmscmd (down 62.5% y-o-y; down 60% q-o-q). CNG volume declined sharply by 77.8% y-o-y to 0.5 mmscmd.
- Weaker-than-expected EBITDA margin at Rs7.9/scm (down 23% y-o-y; down 17.9% q-o-q) as operating leverage got impacted due to sharp volume de-growth.

Our Call

Valuation – Maintain Buy on MGL with unchanged PT of Rs. 1,380: We have lowered our FY2021E EPS to factor in lower volume (due to COVID-19 led demand slowdown) and EBITDA margin assumption. We have largely maintained our FY2022E and FY2023E EPS as volume are expected to normalise to pre-COVID-19 level in FY2022E with easing of lockdown. In our view, the sharp 22% correction in MGL's stock price from 52-week high of Rs. 1,247 factors in volume decline concerns and focus should shift to earnings recovery as overall volume has recovered to 65% of pre-COVID-19 level while EBITDA margin would also improve with higher operating leverage and the recent CNG price hike to recover fixed cost. MGL's valuation is attractive at 11.3x FY2022E EPS (28% discount to its historical average one-year forward PE multiple of 15.7x and a steep discount of 49% to that of IGL on a FY2022E PE basis) despite superior margin and return ratios, FCF yield of 7% and a dividend yield of 4%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.

Key risk

Lower-than-expected gas sales volume in case of delayed recovery due to COVID-19 led slowdown. Any change in domestic gas allocation policy, weak Indian rupee, and adverse regulatory changes could affect margins and valuations.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	2,791	2,972	2,303	2,945	3,134
OPM (%)	31.7	35.4	36.7	40.9	40.9
Adjusted PAT	546	737	586	848	898
% YoY growth	*14.3*	*34.9*	*-20.5*	*44.8*	*5.9*
Adjusted EPS (Rs.)	55.3	74.6	59.3	85.9	90.9
P/E (x)	17.5	13.0	16.3	11.3	10.6
P/B (x)	4.0	3.2	2.9	2.6	2.3
EV/EBITDA (x)	10.5	8.9	11.0	7.4	6.6
RoNW (%)	24.3	27.5	18.9	24.4	22.8
RoCE (%)	34.3	34.3	23.6	30.7	29.0

Source: Company; Sharekhan estimates

Miss in operating profit and PAT due to weaker-than-expected volume and margins: MGL's Q1FY2021 operating profit at Rs. 80 crore (down 71% y-o-y; down 67% q-o-q) was substantially below our estimate of Rs. 100 crore due to lower-than-expected gas sales volumes of 1.1 mmscmd (down 62.5% y-o-y; down 60% q-o-q) and weak margin at Rs7.9/scm (down 23% y-o-y; down 17.9% q-o-q). CNG volumes declined by 78% y-o-y to 0.5mmscmd and PNG volume was down by 21% y-o-y to 0.6mmscmd in Q1FY2021. However, domestic PNG volume increased by 7% y-o-y to 0.4mmscmd as majority of the population was at home due to COVID-19 lockdown. CNG demand was impacted due to the nationwide lockdown by the government to control spread of COVID-19. The margin were impacted as per unit operating expenses surged by 44% q-o-q to Rs. 8.2/scm due to sharp decline in volumes. PAT also declined sharply by 73.4% y-o-y and 72.8% q-o-q to Rs. 45 crore, below our estimate of Rs. 55 crore due to weak-than-expected operating performance partially offset by higher-than-expected other income (up 21% y-o-y).

Q1FY2021 results conference call highlights

- **COVID-19 impact –** The management has mentioned that overall gas sales volume improved to 65% of pre-COVID-19 level in August 2020 and 55% in July 2020 as compared to only 25% of pre-COVID-19 levels in April 2020. CNG volumes are at 50% of pre-COVID levels currently with 50% of auto-rickshaws are back on roads and demand from cab aggregators reached 40% of pre-COVID-19 levels. The CNG volumes are expected to normalise as vehicular traffic improves with the easing of lockdown norms. Commercial PNG volumes are also recovered to 55% of pre-COVID-19 levels for restaurants and 40% for five-star hotels.

- **Capex guidance –** Management has guided for a capex of Rs. 550-600 crore for FY2021E. Out of this, Rs. 120 crore would be spent on Raigad GA and the rest in other areas. However, the achievement of capex target would depend upon timely approval from statutory authorities, housing societies (for laying of pipelines for domestic PNG) and improvement in availability of migrant laborers (normalisation expected in next three months). The strict lockdown in the Mumbai Metropolitan Region (MMR) impacted project work in Q1FY2021.

- **Margin outlook –** With the recent improvement in volume and price hike of Rs. 1/kg for CNG, the per unit EBITDA margin is expected to improve in the coming quarter, given better gross margins (improved by 5% q-o-q to Rs. 16.1/scm). The high per unit operating cost of Rs8.2/scm (up 44% q-o-q in Q1FY2021) is expected to normalise with recovery in volumes.

- **BEST CNG bus additions –** The management has highlighted that 300 new CNG BEST buses were added recently and another 150 CNG buses would be added over August-September, taking total BEST buses on CNG to 2,350. The management has indicated that additional 800-1,000 CNG buses would be added but tendering for the same is still awaited. There is marginal discount of Rs. 1/kg for CNG supply to BEST buses. The BEST buses consumes one lakh kilogram of CNG per day.

- **Open access regulations –** The management said that it would be difficult to say anything on open access as the regulations are yet to be notified by the regulator (PNGRB). Although nothing has been formalised in term of timeline of the regulation but PNGRB expects to come out with it soon. MGL has spare capacity of 20% in its pipelines for open access to third party players. The matter of infrastructure exclusivity is challenged in the Delhi High Court and MGL is also a part to the case. Any competition would depend upon final open access regulations as OMCs already get dealer commission of Rs3.5-4/scm on CNG sales volume.

- **Volume mix –** CNG volume at 0.48mmscmd, Domestic PNG volume at 0.43mmscmd, industrial PNG volume of 0.15 mmscmd and commercial PNG at 0.05 mmscmd.

- **CNG stations –** Total CNG stations are at 256 and out of this 184 are with OMCs. The commission paid to OMCs is in the range of Rs3.5-4/scm and the contract with OMCs is for 3-5 years period. The CNG stations are operating at 50% utilization including owned and OMCs.
- Industrial PNG price was lower on a q-o-q basis at Rs23/scm as compared to Rs. 29/scm in Q4FY2020. Commercial PNG prices also declined to Rs. 28/scm versus Rs. 36/scm in Q4FY2020. The price of both industrial and commercial PNG has improved marginally in Q2FY2021.
- The overdue from domestic PNG segment has increased slightly due to delay in payment from customers. The company has a treasury surplus of ~Rs. 1000 crore.
- The company has achieved minimum work program (MWP) for domestic PNG connections at 26,000 while for MWP for network pipelines is completed only 45% due to COVID-19 challenges.

Result table Rs cr

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Net Sales	262	757	-65.4	687	-61.9
Total Expenditure	182	481	-62.2	443	-58.9
Reported operating profit	80	277	-71.1	244	-67.2
Adjusted operating profit	**80**	**277**	**-71.1**	**244**	**-67.2**
Other Income	25	20	20.6	27	-9.1
EBITDA	105	297	-64.8	271	-61.4
Interest	2	1	11.7	2	-26.4
Depreciation	42	37	13.6	44	-3.9
Exceptional income/(expense)	0	0	-	0	-
Reported PBT	61	259	-76.5	225	-73.0
Adjusted PBT	61	259	-76.5	225	-73.0
Tax	15	88	-82.5	58	-73.4
Reported PAT	45	170	-73.4	167	-72.8
Adjusted PAT	**45**	**170**	**-73.4**	**167**	**-72.8**
Equity Cap (cr)	10	10	-	10	-
Reported EPS (Rs)	4.6	17.2	-73.4	16.9	-72.8
Adjusted EPS (Rs)	4.6	17.2	-73.4	16.9	-72.8
Margins (%)			**BPS**		**BPS**
Adjusted OPM	30.6	36.5	-598.6	35.5	-495.6
Adjusted NPM	17.3	22.5	-518.7	24.3	-697.7

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Volume (mmscmd)	1.1	3.0	-62.5	2.8	-60.0
EBITDA margin (Rs/scm)	7.9	10.3	-23.0	9.6	-17.9
CNG volume (mmscmd)	0.5	2.2	-77.8	2.0	-75.7
PNG volume (mmscmd)	0.6	0.8	-21.2	0.8	-21.3

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Regulatory push and low gas price to drive gas demand in India**

Notwithstanding the near term volume concern due to COVID-19, the long term gas demand potential for India is very strong given regulatory support to curb pollution and low gas prices (both domestic and LNG prices). Additionally, government's aim to increase share of gas in India's overall energy mix to 15% by 2025 (from 6% currently) would substantially improve gas penetration in the country and boost gas consumption. The margins of CGD companies should improve given expectation of further reduction in the domestic gas price over H2FY2021E-H1FY2022E.

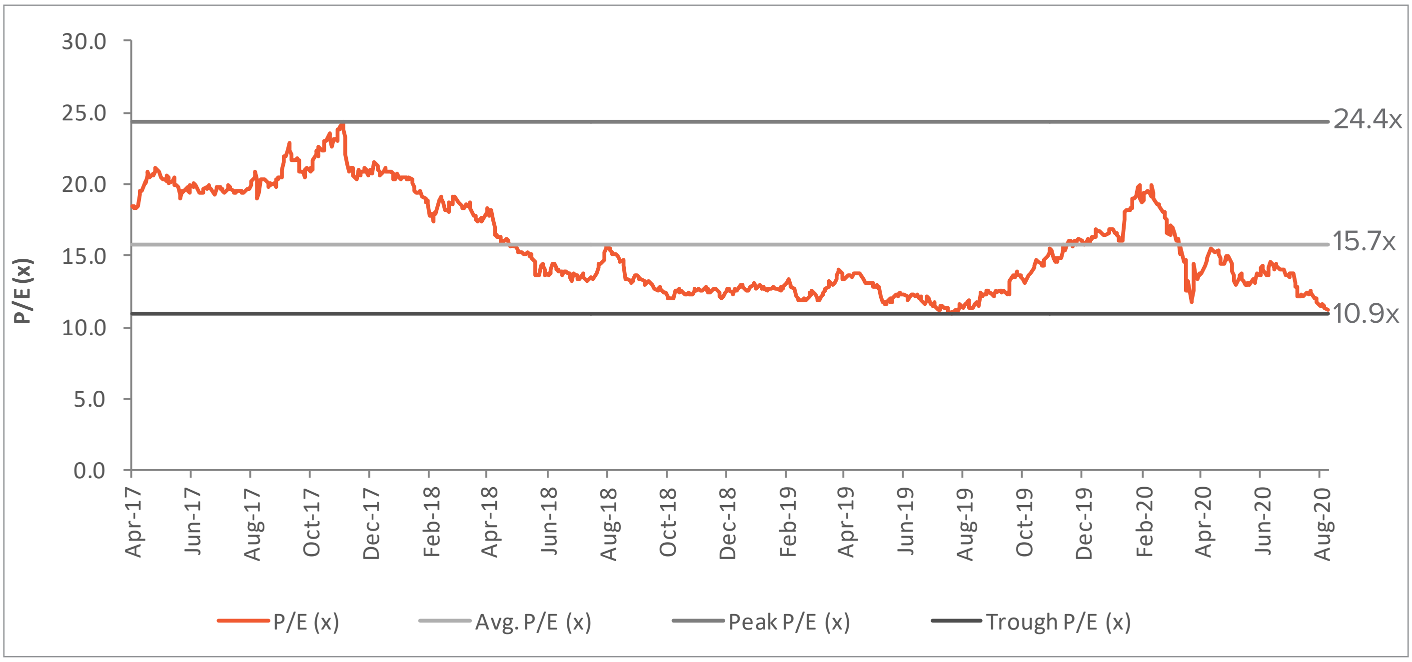
■ **Company Outlook – Low penetration to drive volume growth; low gas cost to expand margins**

MGL is favourably placed to benefit from low CNG penetration of 34% and domestic PNG of 38% in MMR, which provides sustained 6-7% annual volume growth opportunity on long term basis given government's focus to reduce vehicular pollution and increase share of gas in overall energy mix of India. Moreover, any regulatory push to make use of CNG mandatory as a fuel for public transportation (as seen in New Delhi) and development of Raigad GA (0.6 mmscmd volume potential or 20% of MGL's FY2020 gas sales volume) would further add to the company's volume growth prospects. Potential reduction in domestic gas prices over H2FY2021E-H1FY2022E and weak spot LNG prices bodes well for margin expansion. We expect decent 7% PAT CAGR over FY2020-FY2022E with a robust RoE of 24% led recovery in volume and margins.

■ **Valuation – Maintain Buy on MGL with unchanged PT of Rs. 1,380**

We have lowered our FY2021E EPS to factor in lower volume (due to COVID-19 led demand slowdown) and EBITDA margin assumption. We have largely maintained our FY2022E and FY2023E EPS as volume are expected to normalise to pre-COVID-19 level in FY2022E with easing of lockdown. In our view, the sharp 22% correction in MGL's stock price from 52-week high of Rs. 1,247 factors in volume decline concerns and focus should shift to earnings recovery as overall volume has recovered to 65% of pre-COVID-19 level while EBITDA margin would also improve with higher operating leverage and the recent CNG price hike to recover fixed cost. MGL's valuation is attractive at 11.3x FY2022E EPS (28% discount to its historical average one-year forward PE multiple of 15.7x and a steep discount of 49% to that of IGL on a FY2022E PE basis) despite superior margin and return ratios, FCF yield of 7% and a dividend yield of 4%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
MGL	968	10	9,559	16.3	11.3	11.0	7.4	2.9	2.6	18.9	24.4
IGL	389	70	27,244	29.0	22.0	18.3	13.8	4.8	4.2	17.5	20.4
Gujarat Gas	309	69	21,302	24.0	19.8	13.9	11.5	5.3	4.4	24.3	24.5

Source: Sharekhan Estimates

About company

Mahanagar Gas (MGL) is a dominant CGD player in and around Mumbai with CNG/PNG sales volumes of 2.1 mmscmd/0.8 mmscmd in FY2020. MGL derives 73% of its volumes from CNG, 14% from domestic PNG and the remaining from commercial/industrial PNG. The company sources its entire gas requirement for CNG and domestic PNG from low-cost domestic gas. The company has 256 CNG stations, 1.26 million PNG customers and a pipeline network of 5,630 km.

Investment theme

The government's aim to increase the share of gas in India's energy mix to ~15% by 2025 (from 6% currently) and the thrust to reduce air pollution provides a regulatory push for strong growth in CNG and domestic PNG volumes for MGL. The company's margins are expected to remain strong given expectation of downward revision in the domestic gas prices for H2FY2021E and low spot LNG prices. Moreover, MGL's gas sales volume has recovered to 65% of pre-COVID-19 level and expected to further improve given easing of lockdown norms in MMR.

Key Risks

- Lower-than-expected gas sales volume in case of delay in volume recovery due to COVID-19 led demand slowdown.
- Any change in domestic gas allocation policy, depreciation of Indian rupee, and any adverse regulatory changes could affect margins and valuations.

Additional Data

Key management personnel

Manoj Jain	Chairman
Sanjib Datta	Managing Director
Deepak Sawant	Deputy Managing Director
Sunil M Ranade	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Schroders PLC	6.0
2	L&T Mutual Fund Trustee Ltd/India	3.5
3	SBI Life Insurance Co Ltd	2.5
4	Stichting Depositary Apg	1.7
5	Life Insurance Corporation of India	1.6
6	Vanguard Group Inc/The	1.4
7	FMR LLC	1.3
8	Tata Asset Management Ltd	1.1
9	Bajaj Allianz Life Insurance Co Ltd	1.1
10	HDFC Asset Management Co Ltd	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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