Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Mahanagar Gas Limited

## Volume recovery on track; Best-ever margin

| 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. 870** | |
| Price Target: **Rs. 1,380** | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

**Company details**

| | |
|---|---|
| Market cap: | Rs. 8,591 cr |
| 52-week high/low: | Rs. 1,247/666 |
| NSE volume: (No of shares) | 10.2 lakh |
| BSE code: | 539957 |
| NSE code: | MGL |
| Free float: (No of shares) | 6.7 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 32.5 |
| FII | 25.6 |
| DII | 20.1 |
| Others | 21.8 |

**Price chart**


**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 5.2 | -10.4 | -1.4 | -15.5 |
| Relative to Sensex | -3.2 | -24.2 | -47.4 | -24.3 |

*Sharekhan Research, Bloomberg*


**Summary**

- MGL reported much lower-than-expected decline of 32.6% y-o-y in its PAT to Rs. 144 crore (versus our estimate of Rs. 121 crore) in Q2FY2021 due to higher-than-expected EBITDA margin at Rs. 11.6/scm (up 17% y-o-y) and marginal beat in volume at 2.1 mmscmd (up 86.3% q-o-q).
- CNG volume stood at 58% of pre-COVID-19 level at 1.3mmscmd in Q2FY2021, while domestic PNG volume grew by 21.6% y-o-y to 0.46mmscmd and industrial/commercial PNG volume declined by 20% y-o-y to 0.33 mmscmd.
- MGL's earnings are likely to recover sharply in H2FY2021 as overall volumes have recovered to pre-COVID-19 level of 3mmscmd in November with CNG volumes at 90%-95% of pre-COVID-19 level. Overall, we expect a 23% PAT CAGR over FY2021E-FY2023E.
- MGL's stock price has underperformed the Sensex by 25% in the past one year, and we believe post clarity on open access, the stock is likely to gain momentum as earnings recovery is on track. We retain Buy on MGL with an unchanged PT of Rs. 1,380.


**Mahanagar Gas Limited (MGL) reported better-than-expected Q2FY2021 results, as the decline of 19.1%/32.6% y-o-y in its operating profit/PAT to Rs. 221 crore/Rs. 144 crore was much lower than our expectation 31%/55% y-o-y decline. The beat in earnings versus our estimate can be attributed to higher-than-expected EBITDA margin at Rs. 11.6/scm (up 17% y-o-y; up 46.8% q-o-q) and slightly better-than-expected recovery of 69% in gas sales volume at 2.1mmscmd (up 86.3% q-o-q). Improvement in EBITDA margin was driven by a 17.7% y-o-y increase in gross margin at Rs. 17.3/scm, led by lower gas cost, better margin for industrial/commercial (I/C) PNG, led by increased I/C PNG price (to reflect alternative fuel price) and improved operating leverage (opex/scm declined by 30% q-o-q to Rs5.7/scm). CNG volume stood at 58% of pre-COVID-19 level at 1.3mmscmd in Q2FY2021, while domestic PNG volume grew by 21.6% to 0.46mmscmd and I/C PNG volume declined by 20% y-o-y to 0.33mmscmd. We expect MGL's earnings to recover sharply over H2FY2021 as overall volumes have recovered close to pre-COVID-19 level of 3mmscmd in November with high-margin CNG volumes at 90%-95% of pre-COVID-19 level. Although higher spot LNG price would impact margin in the I/C segment, improvement in CNG mix in overall gas sales volume and operating leverage are expected to help sustain margin. MGL's stock price has underperformed the broader index by 25% (MGL stock down by 15% versus 9% rise in Sensex) in the past one year. We believe once clarity emerges on open access regulations, the stock is likely to gain momentum as earnings recovery (expect a 23% PAT CAGR over FY2021E-FY2023E) seems to be on track with volumes close to pre-COVID-19 level. Valuation is also attractive at 9.6x its FY2023E EPS (steep 58% discount to that of IGL on FY2023E PE basis). Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.**

**Key Positives**

- Overall gas sales volume recovered to pre-COVID-19 level of 3mmscmd in November with CNG volume at 90-95% of pre-COVID-19 level.
- Improvement in gross/EBITDA margin by 18%/17% y-o-y to Rs. 17.3/Rs. 11.6/scm in Q2FY2021.
- Domestic PNG volume grew by 21.6% y-o-y and 9.2% q-o-q to 0.46mmscmd.

**Key negatives**

- Overall gas sales volume declined by 31% y-o-y to 2.1mmscmd.

**Our Call**

**Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 1,380:** We have fine-tuned our FY2021-FY2023 earnings estimate to factor lower CNG sales volume, partially offset by higher EBITDA margin assumption. MGL's stock price has underperformed the broader index by 25% (MGL stock down by 15% versus 9% rise in Sensex) in the past one year. We believe once clarity emerges on open access regulations, the stock is likely to gain momentum as earnings recovery seems to be on track with volume close to pre-COVID-19 level. Development of Raigad GA (0.6 mmscmd volume potential over the next 4-5 years or 20% of MGL's FY2020 gas sales volume) would further add to the company's volume growth prospects. Moreover, MGL is the cheapest CGD stock with attractive valuation of 9.6x its FY2023E EPS (steep 58% discount to that of IGL on FY2023E PE basis) despite superior margin and RoE of 23%-24%, FCF yield of 8%, and dividend yield of 4%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.

**Key Risks**

Lower-than-expected gas sales volume in case of delayed recovery due to COVID-19 led slowdown. Delay in development of new GAs, sharp rise in LNG prices, and adverse regulatory changes (revision in APM gas pricing formula) could impact outlook and valuations. Overhang on CGD stocks will stay until open access regulations are finalised by PNGRB.

**Valuation** Rs cr

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Revenue | 2,791 | 2,972 | 2,200 | 2,877 | 3,091 |
| OPM (%) | 31.7 | 35.4 | 38.7 | 41.7 | 41.4 |
| Adjusted PAT | 546 | 737 | 589 | 843 | 897 |
| y-o-y growth (%) | 14.3 | 34.9 | -20.1 | 43.1 | 6.4 |
| Adjusted EPS (Rs.) | 55.3 | 74.6 | 59.6 | 85.3 | 90.8 |
| P/E (x) | 15.7 | 11.7 | 14.6 | 10.2 | 9.6 |
| P/B (x) | 3.6 | 2.9 | 2.6 | 2.3 | 2.1 |
| EV/EBITDA (x) | 9.4 | 7.9 | 9.8 | 6.6 | 5.9 |
| RoNW (%) | 24.3 | 27.5 | 19.0 | 24.2 | 22.8 |
| RoCE (%) | 34.3 | 34.3 | 23.7 | 30.5 | 28.9 |

*Source: Company; Sharekhan estimates*

**Higher-than-expected operating profit/PAT led by beat in margins and slightly better volume**

Q2FY2021 operating profit at Rs. 221 crore (down 19.1% y-o-y; up 2.8x q-o-q) was substantially above our and street estimates. The 18% beat versus our estimate was on the account of higher-than-expected EBITDA margin at Rs. 11.6/scm (up 17% y-o-y; up 46.8% q-o-q) and 4.2% beat in gas sales volume at 2.1mmscmd (down 30.9% y-o-y; up 86.3% q-o-q). CNG volume stood at 58% of pre-COVID-19 level at 1.3mmscmd in Q2FY2021, while domestic PNG volume grew by 21.6% to 0.46mmscmd and I/C PNG volume declined by 20% y-o-y to 0.33mmscmd. Improvement in EBITDA margin was driven by a 17.7% y-o-y increase in gross margin at Rs. 17.3/scm, led by lower gas cost, higher I/C PNG margins and improved operating leverage (opex/scm declined by 30% q-o-q to Rs. 5.7/scm). PAT at Rs. 144 crore (down 32.6% y-o-y; up 3.2x q-o-q) was also above our estimate of Rs. 121 crore due to beat in margin and volumes.

**Q2FY2021 results conference call highlights**

- **COVID-19 impact** – Management has indicated that overall gas sales volume improved to pre-COVID-19 level of 3mmscmd in November 2020. CNG volumes are at 90%-95% of pre-COVID-19 level, with 80% of auto-rickshaws back on roads and demand from cab aggregators reaching 70%-80% of pre-COVID-19 levels. Industrial PNG volumes have fully recovered to pre-COVID-19 level, but commercial PNG volumes are still below pre-COVID-19 levels, especially for restaurants and five-star hotels. CNG conversion is back to pre-COVID-19 level at 6,000 plus per month in October 2020. Total 26,000 new cars and 13,000 new three-wheelers (3W) added to CNG in the past six months.
- **Open access regulations** – Management said that clarity on many aspects has to emerge before effective implementation of open access regulation for CGD. For example, determination of percentage of CGD capacity for open access and even CGD capacity of the entity and determination of transportation tariff (which is to be done by the entity itself as per draft regulations but it is the function of PNGRB). Moreover, the matter of marketing exclusivity is sub judice with Delhi High Court.
- **Capex guidance** – Management has guided for capex of Rs. 500 crore for FY2021E and Rs. 600 crore for FY2022E. The company targets to add 20 plus CNG stations and upgrade 15 existing CNG stations in FY2021.
- **Dealer commission to OMCs (any potential hike to be passed on to end-customers)** – Oil marketing companies (OMCs) have asked for a steep hike in dealer commission and MGL's management is hopeful to resolve the matter through mutual negotiations. The company has the ability to pass on the entire increase in dealer commission to end-customers and historically it has passed on the same. OMCs' dealer commission is in the range of Rs. 3.7-4.0/kg currently, and there has been an average increase of 9% annually over the past 3-5 years.
- **Raigad GA update** – PNG connections are at 26,500, CNG stations at 15 with sales volume 39,000/kg per day. Management has guided to ramp-up Raigad volume to 0.5mmscmd-0.6mmscmd over the next 4-5 years with 95% of volume from CNG and industrial PNG while remaining 5% is expected to come from domestic PNG. The 95% of potential volume from Raigad GA is expected come equally from CNG and industrial PNG. Currently, Raigad GA accounts for only 1%-2% of overall sales volume.
- **PNG and CNG infrastructure addition** - In Q2FY2021, the company added 16,223 domestic PNG customers, taking the total to 1.5 million. MGL had net addition of 28 industrial and commercial (I/C) customers, taking the total to 4,046 as on September 30, 2020. Total CNG stations stood at 259 (addition of three new CNG stations in Q2FY2021) and pipeline network was at 5,650 kms pipeline as on September 30, 2020.
- **Long-term volume and margin guidance** – Management has guided for long-term volume growth of 6%-7% annually and expects margins to remain steady or improve from current levels depending upon volatility in spot LNG and crude oil prices.
- **BEST CNG bus additions** – Management has highlighted that 500 new CNG BEST buses were added recently and another 500-800 CNG buses would be added over the next six months. BEST buses consume one lakh kilogram of CNG per day.
- Industrial PNG price increased on a q-o-q basis at Rs. 29.2/scm (versus Rs. 22.8/scm in Q1FY2021). Commercial PNG prices also increased to Rs. 32/scm as compared to Rs. 28/scm in Q1FY2021. The price of both industrial and commercial PNG remained stable in Q3FY21 so far, but the recent sharp rise in spot LNG price could impact margin of the I/C segment in Q3FY2021.
- PNGRB has extended timeline for minimum work program (MWP) for Raigad GA by 251 days due to COVID-19 challenges.

**Results** Rs cr

| Particulars | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) |
|---|---|---|---|---|---|
| Net Sales | 507 | 784 | -35.3 | 262 | 93.6 |
| Total Expenditure | 286 | 510 | -44.0 | 182 | 57.2 |
| Reported operating profit | 221 | 273 | -19.1 | 80 | 176.4 |
| **Adjusted operating profit** | **221** | **273** | **-19.1** | **80** | **176.4** |
| Other Income | 18 | 23 | -19.8 | 25 | -24.8 |
| EBITDA | 240 | 296 | -19.2 | 105 | 129.2 |
| Interest | 2 | 1 | 40.0 | 2 | 32.7 |
| Depreciation | 42 | 39 | 8.6 | 42 | 0.5 |
| Exceptional income/(expense) | 0 | 0 | NA | 0 | NA |
| Reported PBT | 195 | 256 | -23.8 | 61 | 221.2 |
| **Adjusted PBT** | **195** | **256** | **-23.8** | **61** | **221.2** |
| Tax | 51 | -15 | NA | 15 | 227.7 |
| Reported PAT | 144 | 271 | -46.7 | 45 | 219.0 |
| **Adjusted PAT** | **144** | **214** | **-32.6** | **45** | **219.0** |
| Equity Cap (cr) | 10 | 10 | | 10 | |
| Reported EPS (Rs.) | 14.6 | 27.4 | -46.7 | 4.6 | 219.0 |
| Adjusted EPS (Rs.) | 14.6 | 21.7 | -32.6 | 4.6 | 219.0 |
| **Margins (%)** | | | **BPS** | | **BPS** |
| Adjusted OPM | 43.6 | 34.9 | 873.8 | 30.6 | 1,307.1 |
| Adjusted NPM | 28.5 | 27.3 | 114.1 | 17.3 | 1,119.7 |

*Source: Company; Sharekhan Research*

**Key operating performance**

| Particulars | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) |
|---|---|---|---|---|---|
| Volume (mmscmd) | 2.1 | 3.0 | -30.9 | 1.1 | 86.3 |
| EBITDA margin (Rs./scm) | 11.6 | 9.9 | 17.0 | 7.9 | 46.8 |
| CNG volume (mmscmd) | 1.3 | 2.2 | -42.0 | 0.5 | 165.7 |
| PNG volume (mmscmd) | 0.8 | 0.8 | -0.1 | 0.6 | 25.9 |

*Source: Company; Sharekhan Research*

## Outlook and Valuation

**■ Sector view - Regulatory push and low gas price to drive gas demand in India and benefit CGD players**

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, the 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. Thus, we expect sustainable mid-single digit growth in India's gas demand for the next 4-5 years. Margins of CGD companies (with exposure towards CNG) are expected to remain strong, given weak domestic gas prices.

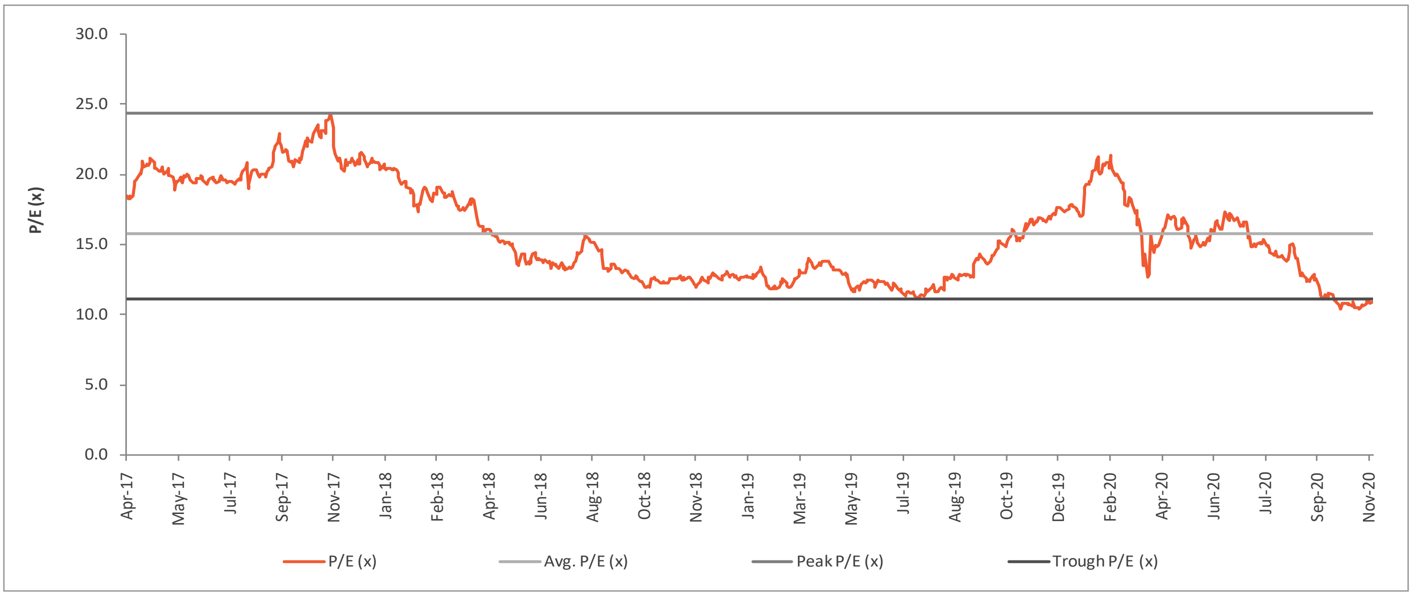
**■ Company outlook - Volume recovery and margin expansion to drive earnings growth**

We expect sustained 6%-7% annual volume growth opportunity on long-term basis, given the government's focus to reduce vehicular pollution and increase share of gas in overall energy mix of India. Moreover, weak domestic gas price bodes well for margin expansion. 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. Hence, we expect a 23% PAT CAGR over FY2021E-FY2022E, with robust RoE of 23%-24%, led by recovery in volume and margin expansion.

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

We have fine-tuned our FY2021-FY2023 earnings estimates to factor in lower CNG sales volume in Q2FY2021, partially offset by higher EBITDA margin assumption. MGL's stock price has underperformed the broader index by 25% (MGL's stock is down by 15% versus 9% rise in Sensex) in the past one year. We believe once clarity emerges on open access regulations, the stock is likely to gain momentum as earnings recovery seems to be on track with volume close to pre-COVID-19 level in November 2020. Moreover, MGL is the cheapest CGD stock with attractive valuation of 9.6x its FY2023E EPS (steep 58% discount to that of IGL on FY2023E PE basis) despite superior margin and RoE of 23%-24%, FCF yield of 8%, and 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 valuation**

| Particulars | CMP (Rs / Share) | P/E (x) | | | EV/EBITDA (x) | | | P/BV (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| MGL | 870 | 14.6 | 10.2 | 9.6 | 9.8 | 6.6 | 5.9 | 2.6 | 2.3 | 2.1 | 19.0 | 24.2 | 22.8 |
| IGL | 439 | 30.9 | 24.7 | 23.1 | 19.8 | 15.6 | 14.0 | 5.4 | 4.7 | 4.2 | 18.5 | 20.4 | 19.2 |
| Gujarat Gas | 311 | 19.0 | 18.4 | 13.9 | 11.6 | 10.8 | 8.0 | 5.1 | 4.2 | 3.4 | 30.1 | 25.2 | 27.3 |

*Source: Company, Sharekhan Research*

## About company

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 259 CNG stations, 1.5 million PNG customers, and a pipeline network of 5,650 km.

## Investment theme

MGL's earnings recovery seems to be on track as volumes have recovered to pre-COVID-19 level and margins are expected to remain strong given weak domestic gas prices. Moreover, 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. 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.

## 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 | Vontobel Holding AG | 7.2 |
| 2 | Life Insurance Corp of India | 4.2 |
| 3 | Schroders PLC | 3.7 |
| 4 | HDFC LIFE INSURANCE COMPANY | 2.5 |
| 5 | L&T Mutual Fund Trustee Ltd/India | 2.4 |
| 6 | FMR LLC | 1.8 |
| 7 | SBI Life Insurance Co Ltd | 1.7 |
| 8 | Stichting Depositary Apg Emerging | 1.5 |
| 9 | Vanguard Group Inc/The | 1.5 |
| 10 | Tata Asset Management Ltd | 1.3 |

*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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