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Stock Update

Mahanagar Gas Limited

Consistent margin outperformance; earnings outlook improving

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. 1,130**	
Price Target: **Rs. 1,380**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 11,157 cr
52-week high/low:	Rs. 1,240/666
NSE volume: (No of shares)	10.6 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	29.6
DII	18.1
Others	19.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.4	29.6	16.3	-4
Relative to Sensex	-3.8	11.9	-17.3	-28

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 operating profit/PAT at Rs. 317 crore/Rs. 217 crore; up 22.4%/16.7% y-o-y and in-line with our estimates but were higher by 12%/10% versus consensus estimates led by a sharp recovery in gas sales volumes (up 32.2% q-o-q) and record-high EBITDA margins of Rs. 12.4/scm (up 34.8% y-o-y).
- CNG/Domestic PNG volume stood at 85%/124% of pre-COVID-19 level at 1.9 mmscmd/0.5 mmscmd; Industrial/Commercial (I/C) PNG volume declined by 9% y-o-y. Highest ever gross margins of Rs. 17.7/scm (up 27.6% y-o-y).
- Improving volume and sustainable high margin bode well for a strong Q4FY21. Double-digit volume growth guidance for FY22 and a 5-6% growth thereafter would drive an 18% PAT CAGR over FY21E-FY23E.
- MGL's underperformance to Sensex is likely to reverse as earnings outlook has improved and overhang of open access is over. Valuation of 12.1x its FY23E EPS is most attractive in the CGD space. We retain Buy on MGL with an unchanged PT of Rs. 1,380.

Mahanagar Gas Limited's (MGL) Q3FY2021 operating profit of Rs. 317 crore (up 22.4% y-o-y; up 43.3% q-o-q) was in line with our estimates but 12% higher-than the consensus estimate of Rs. 282 crore. The strong performance was led by sharp volume recovery to 2.8 mmscmd (up 32.2% q-o-q) and robust EBITDA margin at Rs. 12.4/scm (up 34.8% y-o-y; up 7.2% q-o-q). CNG volume stood at 85% of pre-COVID-19 level at 1.9 mmscmd (down 15% y-o-y; up 47.6% q-o-q) while domestic PNG volume grew strongly by 23.5% y-o-y to 0.5 mmscmd but I/C PNG declined by 9% y-o-y to 0.4 mmscmd. EBITDA margin improved as gross margin rose by 27.6% y-o-y to Rs. 17.7/scm led by lower gas cost and improved operating leverage (opex/scm declined by 7% q-o-q to Rs. 5.3/scm). PAT at Rs. 217 crore (up 16.7% y-o-y; up 50.5% q-o-q) marginally lagged our estimate but was 10% above consensus estimate of Rs. 197 crore led by a beat in margin and volumes. The management has indicated that high-margin CNG volume have further recovered to 91% of pre-COVID-19 level while domestic PNG volumes continue to grow strongly by 15% in January 2021. Improving volume and sustainable high margin (taken price hike of Rs. 1.5/kg for CNG and Rs. 0.95/scm for domestic PNG) bode well for further improvement in earnings for Q4FY2021. The management has guided for high double-digit volume growth for FY2022 (on low base of FY2021) and expects 5-6% volume CAGR over next couple of years. We thus expect PAT to grow at an 18% CAGR over FY2021E-FY2023E along with high RoE of 23-25%. Valuation is attractive at 12.1x its FY2023E EPS [steep discount of 51% to that Indraprastha Gas Limited (IGL) on FY2023E PE basis], given a robust balance sheet, FCF yield of 7%, and dividend yield of 3.2%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,380.

Key positives

- Better-than-expected gross/EBITDA margin at Rs. 17.7/Rs. 12.4 per scm, up 27.6%/34.8% y-o-y in Q3FY2021.
- Domestic PNG volume grew strongly by 23.5% y-o-y to 0.51 mmscmd.

Key negatives

- Industrial/commercial PNG volume was 91% of pre-COVID-19 levels.

Our Call

Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 1,380: We have increased our FY2021 earnings estimates to factor in higher margin assumption and fine-tuned our FY2022-FY2023 earnings estimates. We believe MGL's underperformance versus the broader index (MGL stock price up by 16% versus a 34% rise in Sensex in last six months) should reverse as overhang of open access is over and the focus is expected to shift back to earnings recovery over FY2022E-FY2023E. Moreover, MGL is the cheapest CGD stock with an attractive valuation of 12.1x its FY2023E EPS (steep 51% discount to that of IGL on FY2023E PE basis) despite industry leading margins, RoE of 23%-25%, FCF yield of 7%, and dividend yield of 3.2%. 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. Delay in development of new GAs, a sharp rise in LNG prices, and adverse regulatory changes (revision in APM gas pricing formula) could impact outlook and valuations.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	2,791	2,972	2,145	2,794	3,001
OPM (%)	31.7	35.4	44.5	45.4	43.9
Adjusted PAT	546	737	663	896	926
% YoY growth	14.3	34.9	-10.1	35.2	3.4
Adjusted EPS (Rs. .)	55.3	74.6	67.1	90.7	93.7
P/E (x)	20.4	15.1	16.8	12.5	12.1
P/B (x)	4.7	3.8	3.4	3.0	2.6
EV/EBITDA (x)	12.3	10.4	11.4	8.2	7.6
RoNW (%)	24.3	27.5	21.2	25.4	23.1
RoCE (%)	34.3	34.3	26.7	32.0	29.4

Source: Company; Sharekhan estimates

Operating profit in-line with our estimate but beats street expectation on strong margins and volume performance: Q3FY2021 operating profit of Rs. 317 crore (up 22.4% y-o-y; up 43.3% q-o-q) was in line with our estimates but 12% higher-than the consensus estimate of Rs. 282 crore. The strong performance was led by sharp volume recovery to 2.8 mmscmd (up 32.2% q-o-q) and robust EBITDA margin at Rs. 12.4/scm (up 34.8% y-o-y; up 7.2% q-o-q). CNG volume stood at 85% of pre-COVID-19 level at 1.9 mmscmd (down 15% y-o-y; up 47.6% q-o-q) while domestic PNG volume grew strongly by 23.5% y-o-y to 0.5 mmscmd but I/C PNG declined by 9% y-o-y to 0.4 mmscmd. EBITDA margin improved as gross margin rose by 27.6% y-o-y to Rs. 17.7/scm led by lower gas cost and improved operating leverage (opex/scm declined by 7% q-o-q to Rs. 5.3/scm). PAT at Rs. 217 crore (up 16.7% y-o-y; up 50.5% q-o-q) marginally lagged estimate but was 10% above consensus estimate of Rs. 197 crore led by a beat in margin and volumes.

Q3FY2021 results conference call highlights

- **Business update –** Management indicated that overall gas sales volume is a 2.9 mmscmd in January 2021 with CNG volume at 91% of pre-COVID-19 levels, domestic PNG volume at 115%, Industrial volume at 107% but commercial PNG volumes is still below pre-COVID-19 level given lower demand from restaurants. The management has said 85% of auto-rickshaws and 90% of private cars and cab aggregators back on roads. Volume base is quite diversified across customer segments with 30-35% of volumes coming from auto-rickshaws, 44% from private cars & cab aggregators, 10% from BEST, 5-6% taxis and remaining volume comes from light commercial vehicles.

- **Volume and margin guidance –** The company has guided for high double-digit volume growth for FY2022 (owing to low base in FY2021) and expects 5-6% volume CAGR over next couple of years on the base of FY2022. The management is confident to sustain high margins as pricing power in CNG (73% of volumes in FY2020) gives MGL the ability to pass on APM gas price increase or higher operating cost. The company has recently taken price hike of Rs. 1.5/kg for CNG and Rs. 0.95/scm for domestic PNG so as to recover increase in operating cost related wages and services. The negotiations are going on with OMCs with regards to revision in dealer commission, which would be passed on the end customers.

- **Capex guidance –** Management has guided for capex of Rs. 350-400 for FY2021E and Rs. 650 crore (out of which Rs. 150 crore includes for new corporate offices) for FY2022E. The company has spent Rs. 175 crore on capex in 9MFY2021. The company aims to add 20 plus CNG stations and upgrade 15-20 existing CNG stations in FY2021.

- **Open access regulations –** Open access regulation has been challenged by other CGD companies in the Delhi High Court so it would premature to comment on the same.

- **Raigad GA update –** PNG connections stand at 39,500 while CNG stations number 18 with sales volumes of 41,000/kg per day. In Q3FY2021, the company has laid 41.92kms of pipeline and thus taking total length of the pipeline to 192.33 km.

- **PNG and CNG infrastructure addition -** In Q3FY2021, the company added 49,171 domestic PNG customers, taking the total to 1.5 million. MGL had net addition of 47 industrial and commercial (I/C) customers, taking the total to 4,093 as on December 31, 2020. The total number of CNG stations stood at 265 (addition of six CNG stations in Q3FY2021) and pipeline network was at 5,700 km as on December 31, 2020.

- Industrial PNG price was at Rs. 30.78/scm versus Rs. 29.2/scm in Q2FY2021 and commercial PNG price stood at Rs. 33.72/scm versus Rs. 32/scm in Q2FY2021.

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Net Sales	**666**	**745**	**-10.5**	**507**	**31.5**
Total Expenditure	350	486	-28.0	286	22.4
Reported operating profit	317	259	22.4	221	43.3
Adjusted operating profit	**317**	**259**	**22.4**	**221**	**43.3**
Other Income	20	29	-28.6	18	10.6
EBITDA	337	287	17.3	240	40.7
Interest	2	2	6.2	2	-15.3
Depreciation	44	41	6.4	42	3.9
Exceptional income/(expense)	0	0		0	
Reported PBT	291	244	19.2	195	49.3
Adjusted PBT	**291**	**244**	**19.2**	**195**	**49.3**
Tax	74	58	27.0	51	46.1
Reported PAT	217	186	16.7	144	50.5
Adjusted PAT	**217**	**186**	**16.7**	**144**	**50.5**
Equity Cap (cr)	10	10		10	
Reported EPS (Rs.)	22.0	18.8	16.7	14.6	50.5
Adjusted EPS (Rs.)	22.0	18.8	16.7	14.6	50.5
Margins (%)			**BPS**		**BPS**
Adjusted OPM	47.5	34.8	1275.7	43.6	389.6
Adjusted NPM	32.6	25.0	760.5	28.5	411.0

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Volume (mmscmd)	2.8	3.1	-9.2	2.1	32.2
EBITDA margin (Rs. /scm)	12.4	9.2	34.8	11.6	7.2
CNG volume (mmscmd)	1.9	2.2	-15.3	1.3	46.0
PNG volume (mmscmd)	0.9	0.8	7.2	0.8	10.1

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 the 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 and the favourable economics of CNG versus petrol.

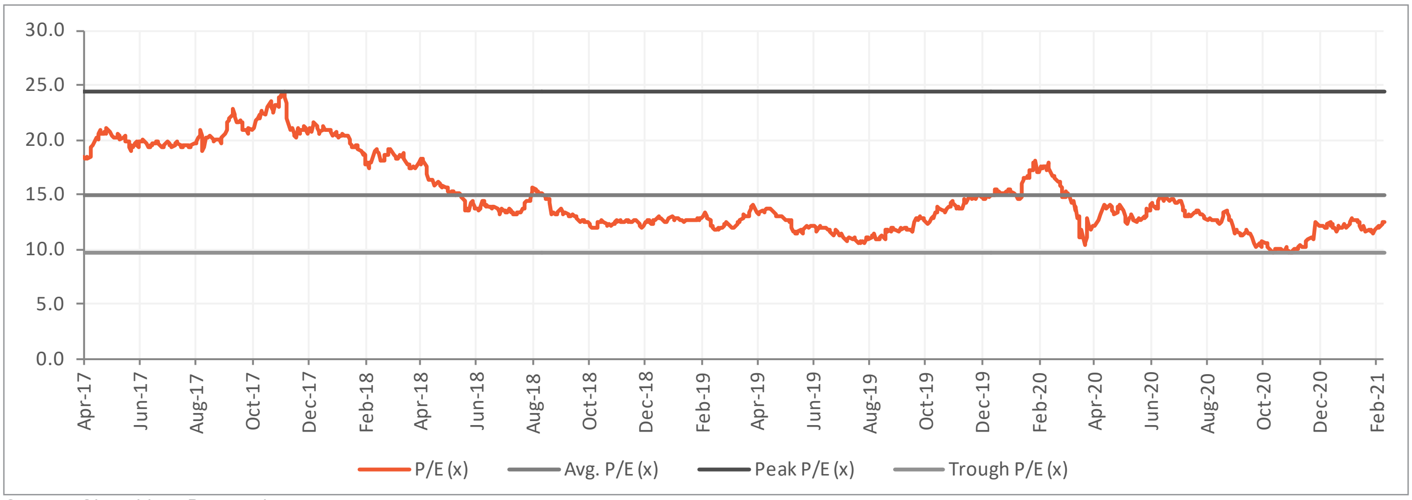
■ **Company Outlook – Volume recovery and margin expansion to drive earnings growth**

We expect sustained 6-7% annual volume growth opportunity on long-term basis, given the government's focus to reduce vehicular pollution and increased share of gas in India's overall energy mix. 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 volume growth prospects. Hence, we expect an 18% PAT CAGR over FY2021E-FY2023E, with robust RoE of 23-25%, led by recovery in volume and margin expansion.

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

We have increased our FY2021 earnings estimates to factor in higher margin assumption and fine-tuned our FY2022-FY2023 earnings estimates. We believe MGL's underperformance versus the broader index (MGL stock price up by 16% versus a 34% rise in Sensex in last six months) should reverse as overhang of open access is over and the focus is expected to shift back to earnings recovery over FY2022E-FY2023E. Moreover, MGL is the cheapest CGD stock with an attractive valuation of 12.1x its FY2023E EPS (steep 51% discount to that of IGL on FY2023E PE basis) despite industry leading margins, RoE of 23%-25%, FCF yield of 7%, and dividend yield of 3.2%. 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

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	7.5
2	Life Insurance Corp of India	5.1
3	FMR LLC	4.3
4	Schroders PLC	2.7
5	HDFC LIFE INSURANCE COMPAN	2.6
6	Vanguard Group Inc/The	1.5
7	L&T Mutual Fund Trustee Ltd/India	1.5
8	SBI Life Insurance Co Ltd	1.3
9	Skandinaviska Enskilda Banken AB	1.0
10	BlackRock Inc	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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