Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Mahanagar Gas Limited

Improving earnings outlook, cheapest CGD stock

Oil & Gas	Sharekhan code: MGL	Company Update

Stock Update

Summary

- MGL's volume outlook has improved considerably, while high margins are sustainable given the favourable economics of CNG versus petrol. This gives us confidence on strong volume/margin-led earnings growth for MGL (expect 18% PAT CAGR over FY21E-FY23E).
- The management expects double-digit volume growth in FY2022 and a sustainable 6% volume growth annually thereafter led by a regulatory push and potential ramp-up of volume at Raigad GA (0.6 mmscmd volume potential).
- We expect high margins for MGL to sustain as pricing power in CNG (accounts for 73% of overall gas sales volumes) gives ability to pass on likely increase in APM gas prices to end customers. Hence, we maintain an EBITDA margin assumption of Rs. 12/Rs. 11.6 per scm over FY21/FY23.
- MGL's 20% underperformance to Sensex in the past one year should reverse as volume growth outlook has improved. MGL's valuation of 12.9x its FY2023E EPS is most attractive in the CGD space. Thus, we retain a Buy with a revised PT of Rs. 1,450.

MGL's has witnessed sharp recovery in high margin CNG volumes to more than 90% of pre-COVID-19 levels, while domestic PNG volumes is witnessing strong growth of 12-15%. Improving volume and sustainable high margin (recently undertaken a price hike of Rs. 1.5/kg for CNG and Rs. 0.95/scm for domestic PNG) bode well for strong growth in earnings in the coming quarters. The management expects high double-digit volume growth for FY2022 (on low base of FY2021) and expects 6% volume CAGR over next couple of years. MGL's long-term volume growth outlook remains intact, supported by structural gas demand drivers such as regulatory push to curb pollution and government's target to increase the share of gas in India's energy mix to 15% by 2030 (from 6% currently). 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 CGD 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. We thus expect PAT to clock an 18% CAGR over FY2021EFY2023E along with high RoE of 23-25%. Valuation is attractive at 12.9x its FY2023E EPS (steep discount of 42% to that of IGL on FY2023E PE basis), given a robust balance sheet, FCF yield of 6%, and dividend yield of 3.1%. Hence, we maintain a Buy rating on MGL with a revised PT of Rs. 1,450.

Our Call

Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,450: We believe that MGL's underperformance versus the broader index (MGL stock price up by 29% versus a 49% rise in Sensex in last one year) should reverse as the 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 12.9x its FY2023E EPS (steep 42% discount to that of IGL on FY2023E PE basis) despite industry leading margins, high RoE of 23-25%, FCF yield of 6%, and dividend yield of 3.1%. Hence, we maintain a Buy rating on MGL with a revised PT of Rs. 1,450 (reflects a higher valuation multiple given expectation of strong volume growth).

Key Risks

Lower-than-expected gas sales volume in case of COVID-19 led demand 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.

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)	21.8	16.2	18.0	13.3	12.9
P/B (x)	5.0	4.0	3.6	3.2	2.8
EV/EBITDA (x)	13.1	11.1	12.2	8.8	8.2
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

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. 1,208**	
Price Target: **Rs. 1,450**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 11,929 cr
52-week high/low:	Rs. 1,257/666
NSE volume: (No of shares)	10.4 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

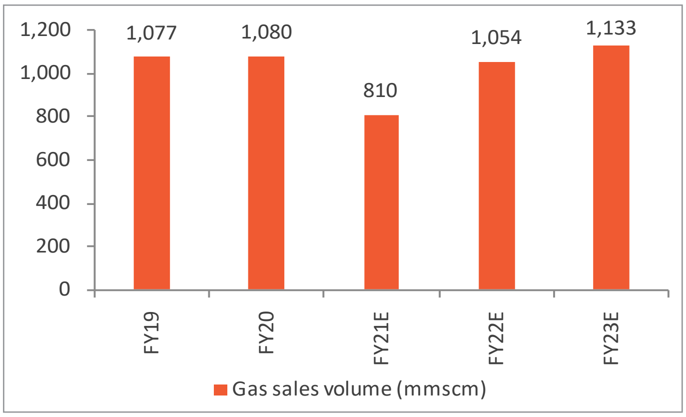
Price performance

(%)	1m	3m	6m	12m
Absolute	7	12	30	29
Relative to Sensex	10	2	-1	-20

Sharekhan Research, Bloomberg

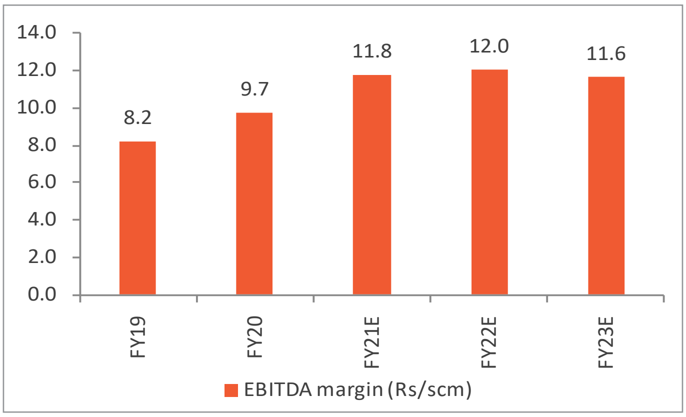
Financials in charts

Volume likely to recover sharply in FY2022E



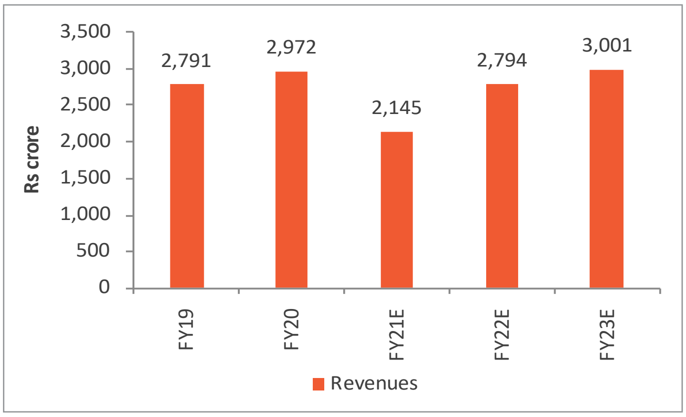
Source: Company, Sharekhan Research

Consistent margin expansion by high share of CNG



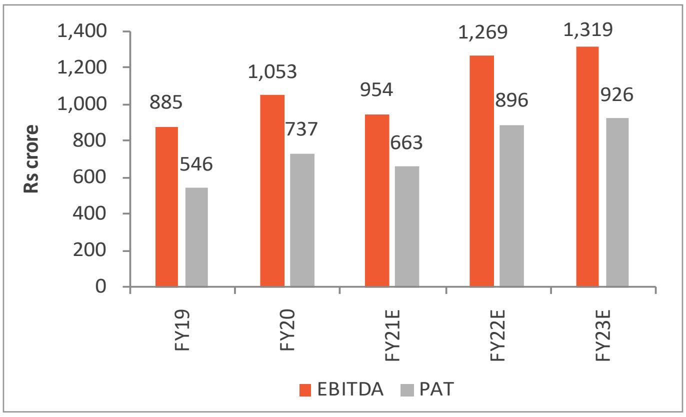
Source: Company, Sharekhan Research

Revenue trend



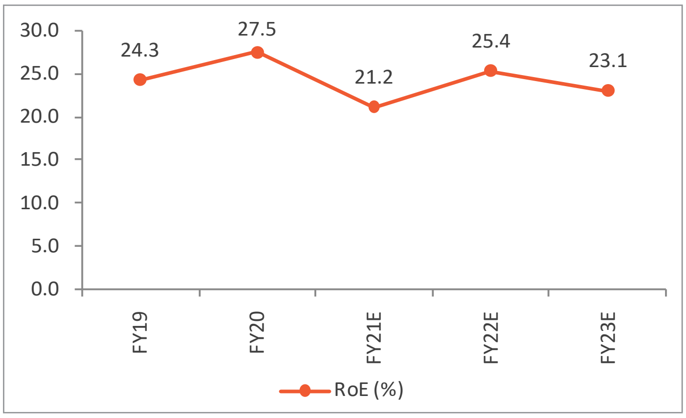
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 18% over FY21E-FY23E



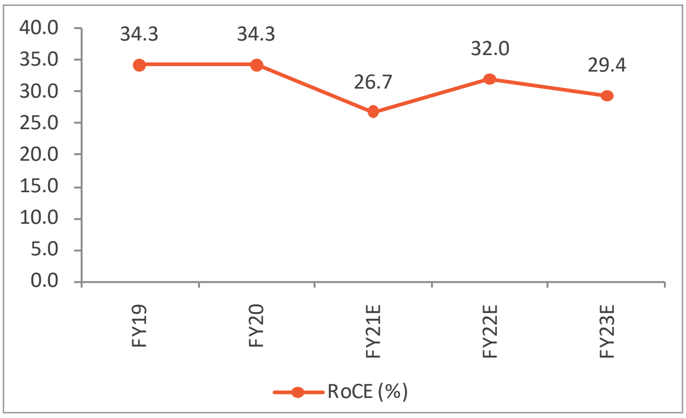
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



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 2030 (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 favourable economics of CNG versus petrol.

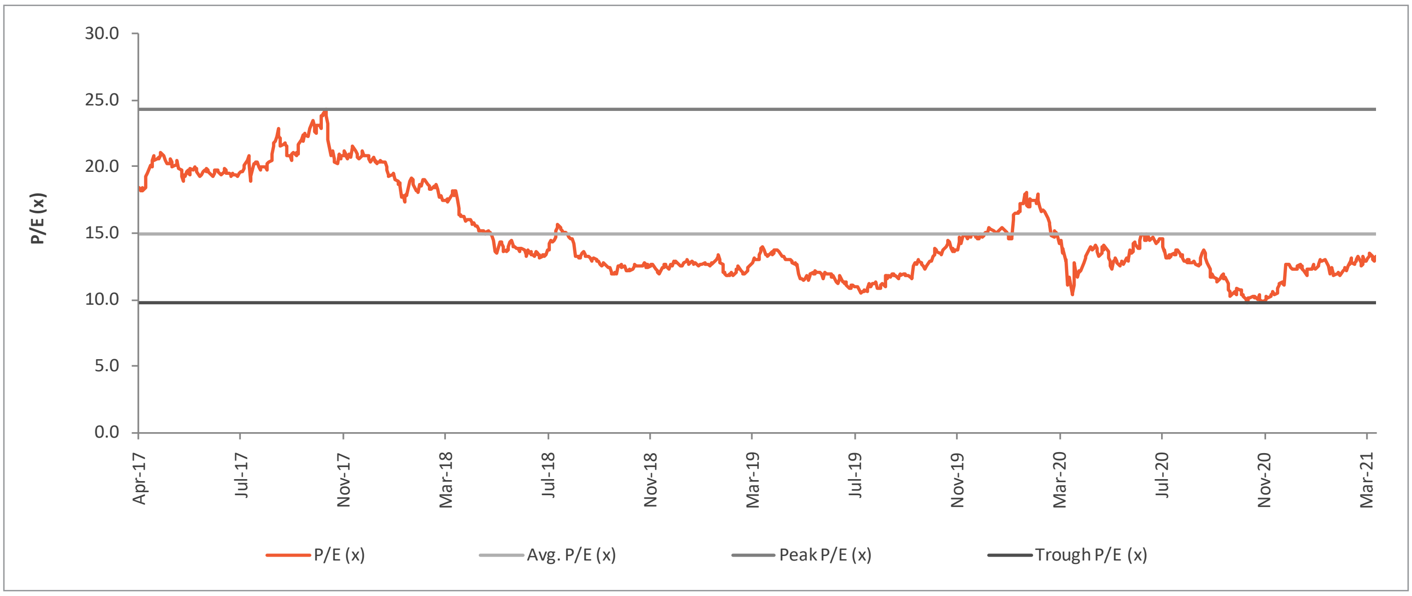
■ Company outlook - Volume recovery and margin expansion to drive earnings growth

We expect a 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 the 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 a recovery in volumes and margins growth.

■ Valuation - Maintain Buy on MGL with a revised PT of Rs. 1,450

We believe that MGL's underperformance versus the broader index (MGL stock price up by 29% versus a 49% rise in Sensex in last one year) should reverse as the 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 12.9x its FY2023E EPS (steep 42% discount to that of IGL on FY2023E PE basis) despite industry leading margins, high RoE of 23-25%, FCF yield of 6%, and dividend yield of 3.1%. Hence, we maintain a Buy rating on MGL with a revised PT of Rs. 1,450 (reflects a higher valuation multiple given expectation of strong volume growth).

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 provide 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 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

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 COMPANY	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; Note: Shareholding as on February 10, 2021

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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