Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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. 1,137**	
Price Target: **Rs. 1,450**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

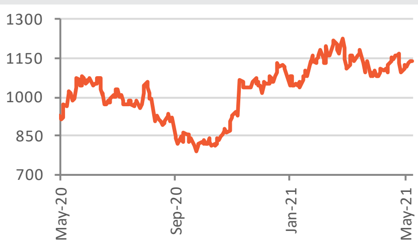
Company details

Market cap:	Rs. 11,234 cr
52-week high/low:	Rs. 1,257 / 780
NSE volume: (No of shares)	8.1 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	31.1
DII	17.2
Others	19.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.2	-1.8	22.3	23
Relative to Sensex	-1.4	-4.9	7.9	-43

Sharekhan Research, Bloomberg

Stock Update

Mahanagar Gas Limited

Q4 slightly off mark; long-term growth outlook stays bright

Oil & Gas	Sharekhan code: MGL	Result Update

Summary

- Q4FY2021 operating profit at Rs. 316 crore; up 29.7% y-o-y and 4.8% below/inline versus ours/street estimates. Numbers lagged our estimates due to lower-than-expected EBITDA margin of Rs. 12.1/scm (down 3.7% q-o-q) and a slightly lower volume at 2.9 mmscmd (up 3.8% y-o-y).
- CNG/domestic PNG volume stood at 102%/109% of pre-COVID-19 level at 2 mmscmd/0.46 mmscmd; Industrial/commercial (I/C) PNG volume at 106% y-o-y. Gross margin remained flat q-o-q at Rs. 17.7/scm.
- Q1FY2022 volumes to get impacted as CNG volume declined by 25-30% versus normal levels due to lockdown; expect a fast recovery as the lockdown eases and vaccination drive gains pace. Ramp-up of the Raigad GA and decent growth in existing GAs would drive long term volume growth.
- MGL's is the cheapest CGD stock with an attractive valuation of 12.2x FY23E EPS. Hence, we retain a Buy on MGL with an unchanged PT of Rs. 1,450. OMCs' demand of high dealer commissions would remain a near-term overhang.

Mahanagar Gas Limited's (MGL) Q4FY2021 operating profit at Rs. 316 crore (up 29.7% y-o-y; flat q-o-q) was 4.8% below our estimates of Rs. 332 crore but in line with street estimates. Lower-than-expected EBITDA versus our estimates was on the account of 3.7%/1.2% miss in the EBITDA margin at Rs. 12.1 per scm/2.9 mmscmd; down 2.2% q-o-q/up 3.8% y-o-y. The miss in EBITDA margin/volume was on the account of marginally lower-than-expected gross margin at Rs. 17.7/scm (flat q-o-q) and higher-than-expected operating cost (opex/scm increased by 4.6% q-o-q to Rs. 5.6/scm). High-margin CNG volume growth of 2% y-o-y to 2 mmscmd was below our expectation of a 4% y-o-y growth, while PNG volume growth of 7.9% y-o-y to 0.9 mmscmd beat expectations. Adjusted PAT at Rs. 213 crore (up 27% y-o-y; down 2% q-o-q) missed our/consensus estimate by 8.5%/3.3% due to lower other income (down 36.3% y-o-y). The management has indicated that CNG volume has witnessed 25-30% decline versus normal level due to lockdown during April'21-May'21 but domestic and industrial PNG volumes remained at normal levels. Margins are expected to remain strong given weak domestic gas prices, correction in spot LNG price and higher alternative fuels (linked to oil prices). We expect CNG volumes to speedily recover as easing of lockdown restrictions and progress in the vaccination drive would normalise vehicular tariff. However, ongoing negotiation with OMCs with regards to revision in dealer commissions would remain an overhang on MGL in the near term. Nevertheless, valuation is attractive at 12.2x its FY2023E EPS [steep discount of 45% to that Indraprastha Gas Limited (IGL) on FY2023E PE basis], given industry-leading margins high RoE/RoCE of 24%/30% and FCF yield of 4-5%. Hence, we maintain a Buy rating on MGL with an unchanged PT of Rs. 1,450.

Key positives

- Better-than-expected domestic PNG volume growth of 9% y-o-y to 0.5 mmscmd.
- Decent FCF generation of Rs. 466 crore (4% yield) in FY2021 despite the pandemic's effect in Q1FY2021.

Key negatives

- Lower-than-expected EBITDA margin of Rs12.1/scm (down 2.2% q-o-q) due to decline in gross margin and high opex.

Our Call

Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 1,450: We have lowered our FY2022 earnings estimates to factor in the impact on volume and margin in Q1FY22 but largely maintain our FY2023 earnings estimates as we expect volumes to recover sharply as easing of lockdown restriction and vaccination drive would normalise vehicular tariff. Long-term volume growth outlook remains strong given decent growth in existing geographical areas, ramp-up of volume at the Raigad GA (volume potential of 0.5mmscmd) and focus on new ideas (like Mobile refueling unit for CNG subject to regulatory approvals and setting up of LNG dispensing outlets). Moreover, MGL is the cheapest CGD stock with an attractive valuation of 12.2x its FY2023E EPS (steep 45% discount to that of IGL on FY2023E PE basis) despite industry leading margins, RoE/RoCE of 24%/30% and FCF yield of 4-5%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,450.

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, a sharp rise in LNG prices, and adverse regulatory changes (revision in APM gas pricing formula) could impact outlook and valuations. OMC demand of high dealer commission would remain an overhang on MGL until resolved.

Valuation Rs cr

Particulars	FY19	FY20	FY21	FY22E	FY23E
Revenues	2,791	2,972	2,153	2,673	3,007
OPM (%)	31.7	35.4	43.4	43.1	43.6
Adjusted PAT	546	737	620	808	920
% YoY growth	*14.3*	*34.9*	*-15.9*	*30.4*	*13.8*
Adjusted EPS (Rs.)	55.3	74.6	62.7	81.8	93.1
P/E (x)	20.6	15.2	18.1	13.9	12.2
P/B (x)	4.7	3.8	3.5	3.1	2.7
EV/EBITDA (x)	12.3	10.5	11.5	9.2	7.7
RoNW (%)	24.3	27.5	20.0	23.5	23.6
RoCE (%)	34.3	34.3	25.4	29.4	29.8

Source: Company; Sharekhan estimates

PAT lags our estimate due to lower-than-expected margin, volumes and other income

Q4FY2021 operating profit at Rs. 316 crore (up 29.7% y-o-y; flat q-o-q) was 4.8% below our estimates of Rs. 332 crore but in line with street estimates. Lower-than-expected EBITDA versus our estimate was on account of a 3.7%/1.2% miss in the EBITDA margin/volume at Rs. 12.1 per scm/2.9 mmscmd; down 2.2% q-o-q/up 3.8% y-o-y. The miss in EBITDA margin was on account of marginally lower-than-expected gross margin at Rs. 17.7/scm (flat q-o-q) and higher-than-expected operating cost (opex/scm increased by 4.6% q-o-q to Rs5.6/scm). High-margin CNG volume growth of 2% y-o-y to 2 mmscmd was below our expectation of 4% y-o-y growth, while PNG volume growth of 7.9% y-o-y to 0.9 mmscmd was above expectation. Adjusted PAT at Rs. 213 crore (up 27% y-o-y; down 2% q-o-q) missed ours/consensus estimate by 8.5%/3.3% due to lower other income (down 36.3% y-o-y).

Q4FY2021 results conference call highlights

- **CNG and PNG volume update:** The management has indicated that CNG volumes declined by 25-30% versus normal levels due to lockdown in April-May but domestic PNG and industrial PNG volumes continue to remain at normal levels. On May 22, 2021, the company saw recorded CNG volume to 1.43 mmscmd and the same has almost bottomed out and management expects V-shaped recovery post the easing out of lockdown norms. Domestic PNG/Industrial PNG volumes are largely normal at 0.52 mmscmd/0.25 mmscmd, while commercial PNG volume (although share is low at 0.12 mmscmd) has got impacted due to lower demand from restaurants.

- **Raigad GA volume guidance:** In the Raigad GA, the company has laid 68.53Km of the pipeline during the quarter, taking the total length of pipeline to 260.9 km. CNG sales at Raigad crossed the average level of 52,000kg/day in March 2021 (versus 41000kg/day) despite movement restrictions, which will go up as more CNG stations become operational. MGL is supplying to domestic PNG to 40,288 households and have 19 CNG stations operational at Raigad GA. The management has guided for a 0.5 mmscmd volume potential over the next 2-3 years based on normal conditions, which do not include any volume from favorable regulations to control pollution.

- **Capex guidance:** The management has guided for a capex of Rs. 500 crore-plus for FY2022 as compared to a capex spending of Rs. 340 crore in FY2021. However, the FY2022 capex is subject to approvals from local bodies in Maharashtra and the potential third wave of COVID-19. It has also planned a small capex of Rs. 10 crore for setting up LNG stations.

- **Update on dealer commission charged by OMC**: The management indicated that negotiation is going in with OMC along with the involvement of MoPNG for revised dealer commission on CNG. OMCs have demanded high single-digit dealer commission. The management highlighted that MGL has high dependency upon OMCs as it derives 65% of CNG volumes from OMC fuel stations.

- **Contingent Liability:** The management highlighted about a contingent liability to the tune of Rs315 crore (for November'08-March'21) related to an ongoing legal case with an upstream PSU for additional transportation tariff for Uran Trombay pipeline as common carrier.

- **Utilisation of Cash balance:** MGL has strong cash balance (including current investment of Rs1025 crore) of Rs1537 crore as of March 2021. The management plans to utilise cash for special dividend, new corporate office, additional customer relationship offices and potential acquisition (not identified yet). However, utilisation cash would depend upon outcome of negotiation with OMCs and legal case with an upstream PSU.

- **Mobile refueling unit (MRU) and LNG station:** The management hinted at new ways to push CNG and is looking at setting-up a mobile refueling unit (to re-fuel CNG vehicles in parking lots etc) for CNG subject to regulatory approvals. Once the company gets regulatory approvals and operational efficiency than it would expand MRUs. In addition, the company is planning to set-up two LNG retailing stations (first LNG station at Panvel by Feb'22 and second by end of next year at Mumbai-Nashik Highway with a capex of Rs. 10 crore per station) as focus is on the LNG transportation fuel market. Both initiatives are at an early stage and would yield result in medium to long term.

- **Margin outlook:** The management is optimistic of high margin to sustain supported by recent price hike (taken in February 2021), weak domestic gas prices, contraction in spot LNG price to $6/mmBtu and higher alternative fuel price (lined to oil prices). However, outcome of negotiation with OMCs would be crucial for margin.
- **Other Income:** The sharp decline of 36% y-o-y and 16% q-o-q was on the account of lower returns from mutual funds/fixed deposits and lower yield in debt market.
- **PNG and CNG infrastructure addition:** In Q4FY2021, the company added 54,688 domestic PNG customers, taking the total to 1.6 million. MGL had net addition of 99 industrial and commercial (I/C) customers, taking the total to 4,192 as on March 31, 2021. The total number of CNG stations stood at 271 (addition of six CNG stations in Q4FY2021) and pipeline network was at 5,916 km (added 166 km in Q4FY2021) as on March 31, 2021.
- **Conversion to CNG vehicles:** The management has said that there were 11,300 cars (including personal cars and cab aggregators) addition to CNG in Q4FY2021 versus 12,100 in Q3FY2021. With respect to auto-rickshaws, there was addition of 2,400 in Q4FY2021 as compared to 3,000 auto-rickshaws in Q3FY2021.

Results Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Net Sales	718	687	4.5	666	7.7
Total Expenditure	402	443	-9.3	350	14.8
Reported operating profit	316	244	29.7	317	-0.2
Adjusted operating profit	**316**	**244**	**29.7**	**317**	**-0.2**
Other Income	17	27	-36.3	20	-15.8
EBITDA	333	271	23.1	337	-1.1
Interest	2	2	-7.7	2	11.6
Depreciation	45	44	1.9	44	1.6
Exceptional income/(expense)	0	-1	NA	0	NA
Reported PBT	287	225	27.5	291	-1.6
Adjusted PBT	**287**	**226**	**27.0**	**291**	**-1.6**
Tax	74	58	27.0	74	-0.4
Reported PAT	213	167	27.7	217	-2.0
Adjusted PAT	**213**	**167**	**27.0**	**217**	**-2.0**
Equity Cap (cr)	10	10		10	
Reported EPS (Rs)	21.5	16.9	27.7	22.0	-2.0
Adjusted EPS (Rs)	21.5	17.0	27.0	22.0	-2.0
Margins (%)			**BPS**		**BPS**
Adjusted OPM	44.1	35.5	853.9	47.5	-347.3
Adjusted NPM	29.6	24.4	525.5	32.6	-294.7

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Volume (mmscmd)	2.89	2.8	3.8	2.8	3.2
EBITDA margin (Rs/scm)	12.1	9.6	26.2	12.4	-2.2
CNG volume (mmscmd)	2.0	2.0	2.2	1.9	6.3
PNG volume (mmscmd)	0.9	0.8	7.9	0.9	-3.2

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 domestic gas 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 its 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 to CNG) are expected to remain strong, given weak domestic gas prices and the favourable economics of CNG versus petrol.

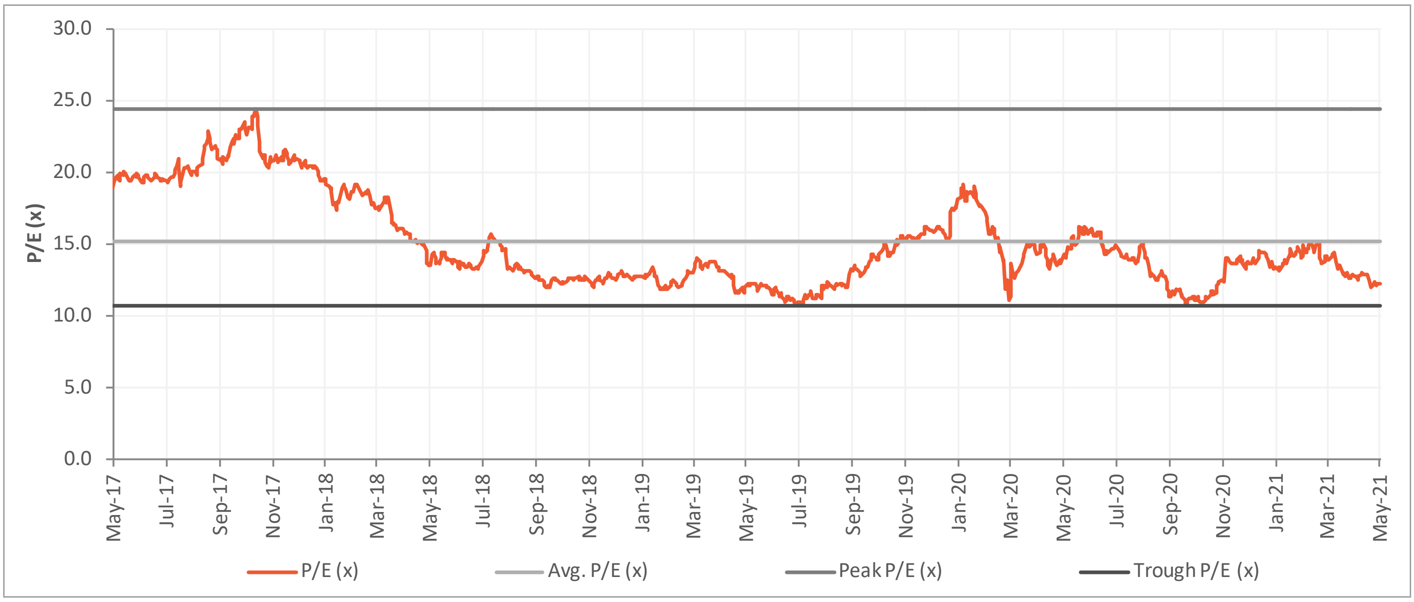
■ Company outlook - Q1FY22 volumes to get impacted by lockdown; long term growth story intact

The second wave of COVID-19 and a resultant lockdown in Maharashtra has lowered vehicular traffic and thus impacted CNG demand by 25-30% versus normal levels. We thus expect MGL's volumes to be lower in Q1FY2022 but expect a speedy recovery with easing of lockdown restrictions and improvement in vaccination drive in India. Overall, 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, a weak domestic gas price bodes well for margin expansion. Development of Raigad GA (0.5 mmscmd volume potential or 17% of current gas sales volume run-rate) would further add to volume growth prospects. Hence, we expect a 14% PAT CAGR over FY2021-FY2023E and robust RoE of 24%.

■ Valuation - Maintain Buy on MGL with an unchanged PT of Rs. 1,450

We have lowered our FY2022 earnings estimates to factor in the impact on volume and margin in Q1FY22 but largely maintain our FY2023 earnings estimates as we expect volumes to recover sharply as easing of lockdown restriction and vaccination drive would normalise vehicular tariff. Long-term volume growth outlook remains strong given decent growth in existing geographical areas, ramp-up of volume at the Raigad GA (volume potential of 0.5mmscmd) and focus on new ideas (like Mobile refueling unit for CNG although subject to regulatory approvals and setting up of LNG dispensing outlets). Moreover, MGL is the cheapest CGD stock with an attractive valuation of 12.2x its FY2023E EPS (steep 45% discount to that of IGL on FY2023E PE basis) despite industry leading margins, RoE/RoCE of 24%/30% and FCF yield of 4-5%. Hence, we maintain our Buy rating on MGL with an unchanged PT of Rs. 1,450.

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 long term volume growth outlook is strong supported by 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 (0.5 mmscmd volume potential or 17% of current volume run-rate) would further add to the company's volume growth prospects. Weak domestic gas price bodes well for sustained high margin. MGL is the cheapest CGD stock.

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.
- OMC demand of high dealer commission would remain an overhang on MGL until resolved.

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	8.0
2	Life Insurance Corp of India	5.6
3	FMR LLC	4.5
4	Schroders PLC	3.3
5	HDFC Life Insurance Company	2.6
6	Vanguard Group Inc.	1.5
7	SBI Life Insurance Co. Ltd	1.4
8	Skandinaviska Enskilda Banken AB	1.0
9	L&T Mutual Fund Trustee	1.0
10	ASI Emerging Markets Fund	1.0

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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