

SELL

TP: Rs 750 | ▼ 15%

MAHANAGAR GAS

Oil & Gas

13 November 2020

Margins surge but volume recovery lags peers

Mahanagar Gas's (MAHGL) Q2FY21 PAT outperformed at Rs 1.4bn (-46% YoY, +3x QoQ). Q2 highlights: (a) Volumes were above estimates at 2.1mmscmd (-31% YoY), recovering 88% QoQ. (b) EBITDA margins swelled to Rs 11.6/scm (+17% YoY), driving the overall beat on earnings. We expect the extended lockdown in the Mumbai region to keep CNG volumes sluggish until H1FY22, leading us to cut FY21/FY22 earnings by 8%/13%. Our Sep'21 DCF-based TP remains unchanged at Rs 750. Maintain SELL.

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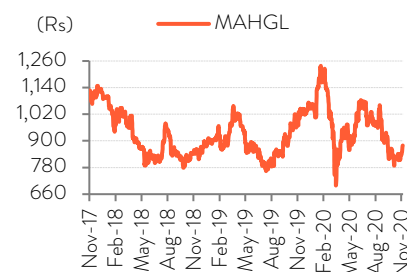
Volume recovery lags peers: MAHGL's CNG volumes surged 2.6x QoQ to 117mmscm (-42% YoY) in Q2, but relatively underperformed peers. Revival to pre-Covid demand levels could be delayed to H1FY22 considering the extended lockdown in Mumbai (buses being hit the most as school reopening stands postponed to FY22). Over the long term, rising infrastructure constraints in Mumbai for CNG outlet expansion and improving alternate travel options (metro) suggest volume growth may remain weak.

Ticker/Price	MAHGL IN/Rs 879
Market cap	US\$ 1.2bn
Shares o/s	99mn
3M ADV	US\$ 12.4mn
52wk high/low	Rs 1,246/Rs 664
Promoter/FPI/DII	33%/30%/38%

Source: NSE

Margins surge: Q2 EBITDA margin expanded to Rs 11.6/scm as CNG volumes increased, and MAHGL used its pricing advantage primarily to limit the YoY impact on earnings. We raise our margin estimates to ~Rs 11/scm (from Rs 10 earlier) but trim volume assumptions by ~10% over FY21/FY22. These margins may not sustain beyond FY21 as MAHGL would need to chase volume growth, especially in the industrial and commercial PNG segments.

STOCK PERFORMANCE



Source: NSE

Maintain SELL: Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter. MAHGL lags peers on volume growth and would need to compromise on margins eventually. Expansion into new areas could also be delayed due to the pandemic impact.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	27,911	29,721	24,145	29,290	35,006
EBITDA (Rs mn)	8,855	10,528	9,936	10,725	12,384
Adj. net profit (Rs mn)	5,464	7,935	6,875	7,254	8,349
Adj. EPS (Rs)	55.3	80.3	69.6	73.4	84.5
Adj. EPS growth (%)	14.3	45.2	(13.4)	5.5	15.1
Adj. ROAE (%)	24.3	29.7	22.2	21.4	22.5
Adj. P/E (x)	15.9	10.9	12.6	12.0	10.4
EV/EBITDA (x)	9.7	8.1	8.5	7.8	6.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

Y/E March (Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net sales	5,067	7,836	(35.3)	2,618	93.6	7,685	15,411	(50.1)
Raw Material Consumed	1,771	3,785	(53.2)	988	79.2	2,759	7,267	(62.0)
% of sales	34.9	48.3	-	37.8	-	35.9	47.2	-
Other expenditure	1,086	1,317	(17.6)	829	30.9	1,915	2,641	(27.5)
% of sales	21.4	16.8	-	31.7	-	24.9	17.1	-
EBITDA	2,211	2,734	(19.1)	800	176.4	3,011	5,502	(45.3)
EBITDA margin (%)	43.6	34.9	-	30.6	-	39.2	35.7	-
EBITDA (Rs/scm)	11.6	9.9	17.0	7.9	46.8	10.3	10.1	2.3
Depn and amortization	425	391	8.6	423	0.5	847	763	11.0
Interest	20	15	40.0	15	32.7	36	28	26.2
Other income	184	230	(19.8)	245	(24.8)	430	433	(0.9)
Profit Before Tax	1,950	2,558	(23.8)	607	221.2	2,558	5,145	(50.3)
Provision for tax	507	(148)	(443.0)	155	227.7	662	736	(10.1)
-effective tax rate (%)	26.0	(5.8)	-	25.5	-	25.9	14.3	-
PAT (reported)	1,443	2,706	(46.7)	452.5	219.0	1,896	4,409	(57.0)
Total income	1,450	2,691	(46.1)	447	224.2	1,887	4,409	(57.2)
Reported EPS (Rs)	14.6	27.4	(46.7)	4.6	219.0	19.2	44.5	(56.9)

Source: Company, BOBCAPS Research

FIG 2 – VOLUME BREAKUP

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
CNG Volumes (mmscm)	117	203	(42.0)	44	168.6	161	400	(59.7)
PNG Volumes (mmscm)	73	73	(0.1)	58	27.3	131	147	(10.6)
Industrial/Commercial	31	38	(19.9)	19	65.3	49	75	(34.3)
Domestic	43	35	21.6	39	9.2	82	71	14.2
Total Volumes (mmscm)	191	276	(30.9)	101	88.3	292	546	(46.5)
Total Volumes (mmscmd)	2.07	3.00	(30.9)	1.10	88.3	1.59	2.98	(46.8)

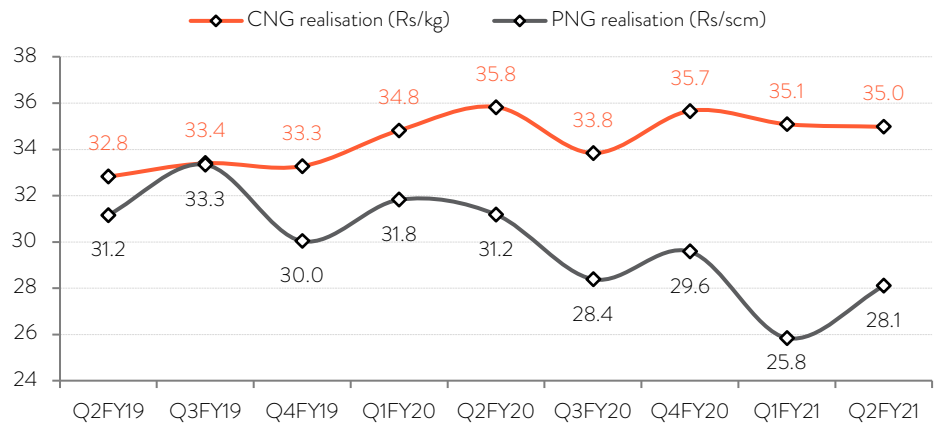
Source: Company, BOBCAPS Research

FIG 3 – OPERATING PERFORMANCE

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Avg realisation (Rs/scm)	26.6	28.4	(6.4)	25.8	2.8	26.3	28.2	(6.8)
Gas cost (Rs/scm)	9.3	13.7	(32.3)	9.8	(4.9)	9.5	13.3	(28.5)
Gross spreads (Rs/scm)	17.3	14.7	17.7	16.1	7.5	16.8	14.9	12.6
CNG realisation (Rs/kg)	35.0	35.8	(2.4)	35.1	(0.3)	35.0	35.7	(1.8)
PNG realisation (Rs/scm)	28.1	31.2	(9.9)	25.8	8.7	27.0	31.8	(15.3)
EBITDA (Rs/scm)	11.6	9.9	17.0	7.9	46.8	10.3	10.1	2.3
Other operating costs (Rs/scm)	5.7	4.8	19.3	8.2	(30.5)	6.5	4.8	34.1

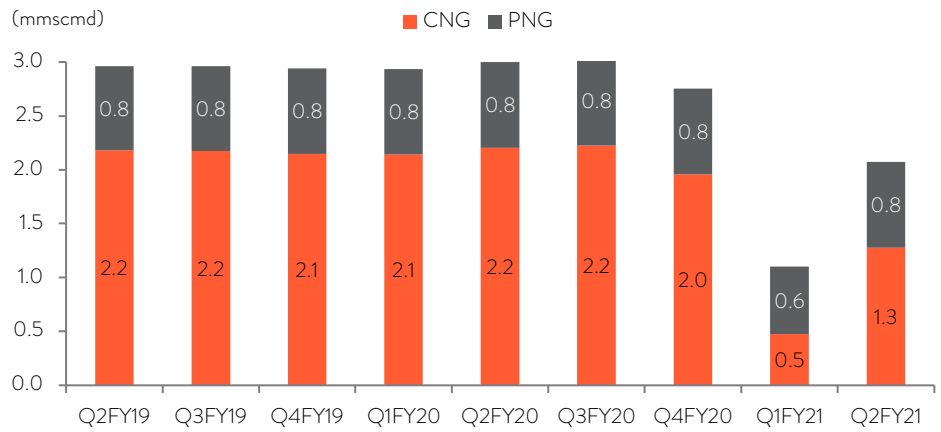
Source: Company, BOBCAPS Research

FIG 4 – CNG AND PNG REALISATIONS



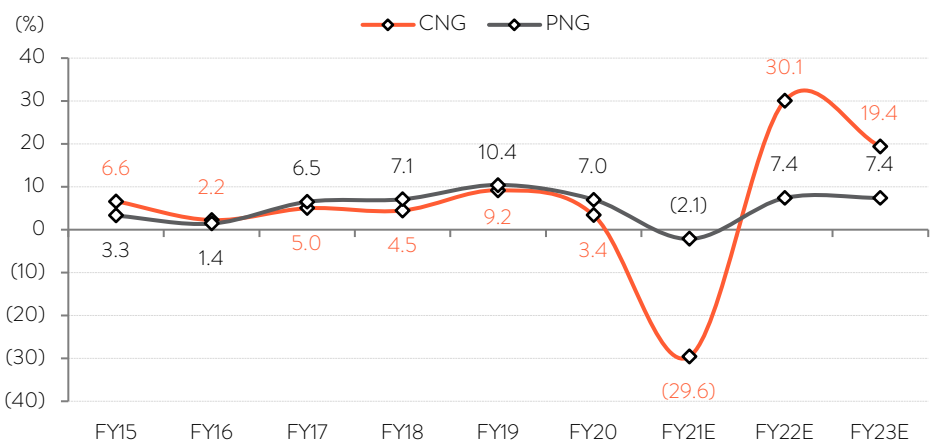
Source: Company, BOBCAPS Research

FIG 5 – VOLUME COMPOSITION



Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH OUTLOOK



Source: Company, BOBCAPS Research

Valuation methodology

Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter. MAHGL lags peers on volume growth and would need to compromise on margins eventually. Expansion into new areas could also be delayed due to the pandemic impact.

We expect the extended lockdown in the Mumbai region to keep CNG volumes sluggish until H1FY22, leading us to cut FY21/FY22 earnings by 8%/13%. Our Sep'21 DCF-based target price remains unchanged at Rs 750. Maintain SELL.

FIG 7 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	27,877	24,145	(13.4)	32,819	29,290	(10.8)	34,866	35,006	0.4
EBITDA	10,626	9,936	(6.5)	12,112	10,725	(11.5)	12,382	12,384	0.0
EBITDA margin (%)	38.1	41.2	-	36.9	36.6	-	35.5	35.4	-
PAT	7,437	6,875	(7.6)	8,381	7,254	(13.4)	8,408	8,349	(0.7)
PAT margin (%)	26.7	28.5	-	25.5	24.8	-	24.1	23.9	-
EPS (Rs)	75.3	69.6	(7.6)	84.8	73.4	(13.4)	85.1	84.5	(0.7)

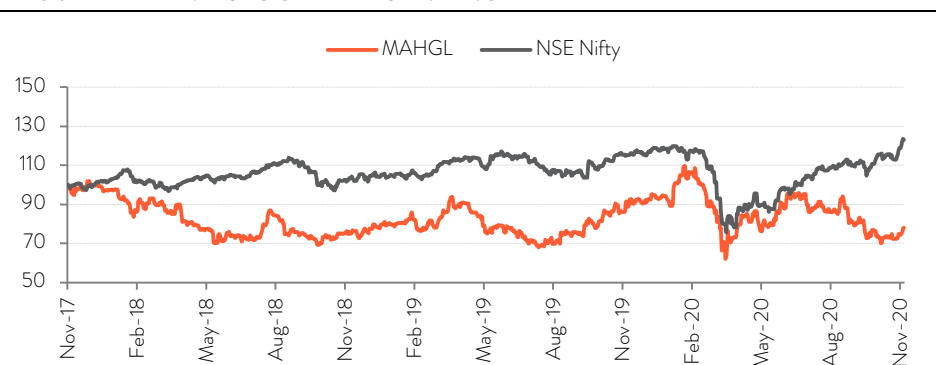
Source: Company, BOBCAPS Research

FIG 8 – VALUATION SUMMARY

Valuation parameters	(Rs mn)
WACC (%)	9.6
Terminal Year growth (%)	2.0
PV of FCF	14,870
PV of terminal value	47,331
Firm Value	62,200
Less Net Debt	(11,899)
Equity value	74,099
Equity Value (Rs/share)	750

Source: BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our estimates are:

- above-expected operating margins,
- higher-than-estimated volume growth for CNG and PNG, and
- faster-than-expected expansion of MAHGL's areas of operation on successful placement of winning bids in PNGRB's upcoming CGD rounds.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	27,911	29,721	24,145	29,290	35,006
EBITDA	8,855	10,528	9,936	10,725	12,384
Depreciation	(1,259)	(1,617)	(1,700)	(1,902)	(2,144)
EBIT	7,595	8,911	8,236	8,823	10,240
Net interest income/(expenses)	(3)	(65)	0	0	0
Other income/(expenses)	777	990	943	862	907
EBT	8,369	9,835	9,179	9,684	11,147
Income taxes	(2,905)	(1,900)	(2,304)	(2,431)	(2,798)
Reported net profit	5,464	7,935	6,875	7,254	8,349
Adjusted net profit	5,464	7,935	6,875	7,254	8,349

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	1,524	1,318	616	824	1,013
Other current liabilities	6,637	8,571	6,228	8,138	9,916
Provisions	212	263	253	267	307
Other liabilities	2,048	1,607	2,075	2,569	3,137
Equity capital	988	988	988	988	988
Reserves & surplus	23,001	28,539	31,391	34,401	37,865
Shareholders' fund	23,989	29,527	32,379	35,389	38,853
Total liabilities and equities	34,410	41,285	41,551	47,186	53,226
Cash and cash eq.	2,988	2,295	3,404	2,786	2,798
Accounts receivables	996	685	595	722	863
Inventories	191	186	132	160	192
Other current assets	2,168	1,268	1,268	1,268	1,268
Investments	6,736	11,495	8,495	10,495	12,495
Net fixed assets	17,588	20,446	22,205	24,924	27,815
CWIP	3,697	4,865	5,406	6,784	7,749
Total assets	34,364	41,239	41,505	47,140	53,180

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	6,723	9,552	8,576	9,156	10,493
Changes in working capital	1,051	2,995	(2,912)	1,977	1,835
Other operating cash flows	(486)	(1,420)	(475)	(368)	(338)
Cash flow from operations	7,288	11,128	5,188	10,765	11,990
Capital expenditures	(3,658)	(5,644)	(4,000)	(6,000)	(6,000)
Change in investments	141	(4,759)	3,000	(2,000)	(2,000)
Cash flow from investing	(3,517)	(10,403)	(1,000)	(8,000)	(8,000)
Debt raised/repaid	(12)	0	0	0	0
Dividends paid	(3,197)	(4,643)	(4,023)	(4,244)	(4,885)
Other financing cash flows	1,508	3,225	943	862	907
Cash flow from financing	(1,701)	(1,418)	(3,079)	(3,382)	(3,978)
Changes in cash and cash eq.	2,070	(694)	1,109	(618)	12
Closing cash and cash eq.	2,989	2,295	3,404	2,786	2,798

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	55.3	80.3	69.6	73.4	84.5
Adjusted EPS	55.3	80.3	69.6	73.4	84.5
Dividend per share	27.7	40.2	34.8	36.7	42.3
Book value per share	242.9	298.9	327.8	358.3	393.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.1	2.9	3.5	2.9	2.4
EV/EBITDA	9.7	8.1	8.5	7.8	6.8
Adjusted P/E	15.9	10.9	12.6	12.0	10.4
P/BV	3.6	2.9	2.7	2.5	2.2

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	65.3	80.7	74.9	74.9	74.9
Interest burden (PBT/EBIT)	110.2	110.4	111.5	109.8	108.9
EBIT margin (EBIT/Revenue)	27.2	30.0	34.1	30.1	29.3
Asset turnover (Revenue/Avg TA)	86.6	78.6	58.4	66.1	69.8
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.3	1.3	1.4
Adjusted ROAE	24.3	29.7	22.2	21.4	22.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.0	6.5	(18.8)	21.3	19.5
EBITDA	13.5	18.9	(5.6)	7.9	15.5
Adjusted EPS	14.3	45.2	(13.4)	5.5	15.1
Profitability & Return ratios (%)					
EBITDA margin	31.7	35.4	41.2	36.6	35.4
EBIT margin	27.2	30.0	34.1	30.1	29.3
Adjusted profit margin	19.6	26.7	28.5	24.8	23.9
Adjusted ROAE	24.3	29.7	22.2	21.4	22.5
ROCE	22.1	26.9	19.9	19.5	20.7
Working capital days (days)					
Receivables	12	10	10	8	8
Inventory	6	5	6	4	4
Payables	25	27	25	14	15
Ratios (x)					
Gross asset turnover	1.1	1.0	0.7	0.8	0.8
Current ratio	0.8	0.4	0.8	0.5	0.5
Net interest coverage ratio	2,352.9	136.5	0.0	0.0	0.0
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

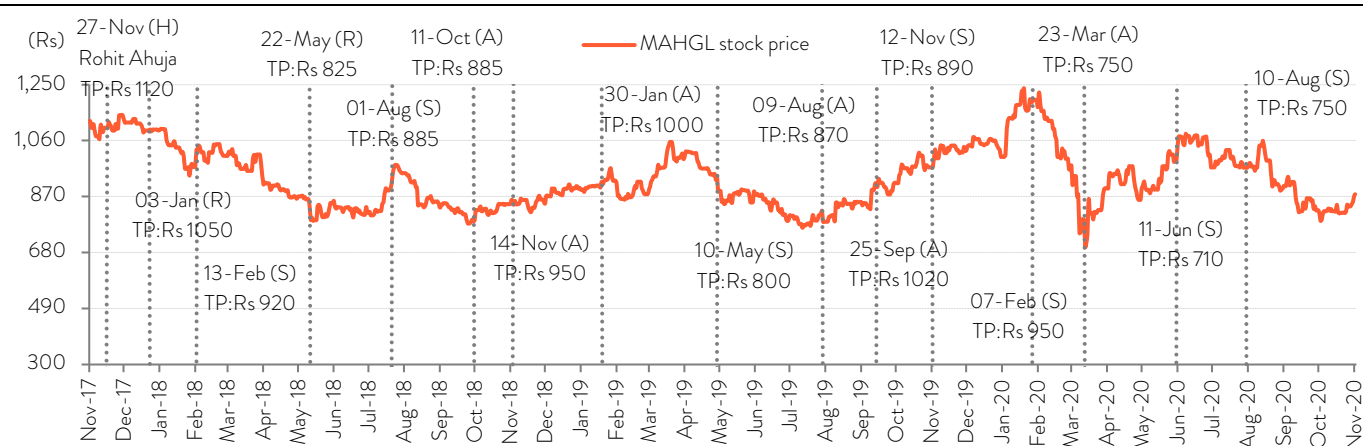
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): MAHANAGAR GAS (MAHGL IN)



B – Buy, A – Add, R – Reduce, S – Sell, H – Hold

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