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DEMOCRATIZING WEALTH CREATION

VALUE PICK
CHASING VALUE, NOT PRICES

February 2019

Company Name	:	**MAHANAGAR GAS**
BSE Code	:	**539957**
Time Duration	:	**1 year**
CMP	:	**₹865 (as on 14 Feb., 2019)**
Target Price	:	**₹1045**

Our Value Pick for the month of February 2019 is Mahanagar Gas (MGL), a natural gas distribution company. It is engaged in supplying natural gas in Mumbai and is presently the sole authorised distributor of compressed natural gas (CNG) and piped natural gas (PNG) in Mumbai and its adjoining areas and Raigad district in the state of Maharashtra. The company procures natural gas primarily from GAIL (India) which owns nearly 32 per cent stake in Mahanagar Gas.

Low-cost substitute for import-dependent petrol & diesel

The cost of CNG is far lower i.e. 35-45 per cent than diesel and petrol in Mumbai which gives a competitive edge for companies like Mahanagar Gas to sustain and command higher margins going forward. Besides, the government is seriously focusing on reducing pollution and for which it is offering incentives for adoption of CNG in transportation as well as in industrial and commercial space. Other fuels, Petrol, diesel and LPG are largely imported and therefore a reason for shifting to CNG.

The government's priority allocation of domestic gas to the city gas distribution sector has enabled MGL to access cheaper gas for CNG and domestic business segments (accounts for around 86 per cent of overall sales volume). Considering the cost economics of natural gas over the other alternative fuels amid rising pollution concerns puts companies like MGL in a sweet spot.

Sustainable margins through pricing power

As the price of natural gas is cheaper than other fuels, it gives more headroom for MGL to go for price hikes. During Q3FY19, the company has managed to pass on the burden of higher input cost through price hikes without taking much hit on its performance, which reveals its pricing power. It has increased the basic price of CNG by Rs. 2.66 per kilogram and domestic PNG by Rs. 1.89 per SCM from October 1, 2018. This price hike would have a negligible impact of around Rs. 0.10/km to Rs. 0.13/km on running costs of auto rickshaws and taxis. The company commands the highest EBITDA per scm in the industry. Also, the management of MGL has indicated that it would maintain its EBITDA margins around Rs 8/scm, in the coming quarters and we concur.

Expansion to boost volume, going ahead

The company presently has almost 224 CNG stations and aims to add around 20 stations in this fiscal itself. The management has given a capex guidance of around Rs. 375 crore and major capex is likely to be employed for expansion in Raigad as MGL has obtained critical approval in this region. Capex for opening a single station is approximately Rs. 2.25 crore. In term of PNG segment, the company aims to add around 1.5 lakh PNG connections per year to its existing base of ~11 lakh connections. Over the past quarters, the company has been beating its own volume guidance and with this expansion, we believe the company could easily achieve its own volume guidance of around 6-7 per cent. Notably, the company's strong gas pipeline infrastructure and expanding operations in Mumbai and its adjoining areas and Raigad district will enable it to capitalise the opportunities offered by the large and growing market with low penetration.

Bidding for new GAs allocated in 10th round of city gas distribution

The 10th city gas licence round by PNGRB is aimed at fulfilling the government's objective of increasing share of natural gas in the primary energy basket from the present 6.2 per cent to 15 per cent in the next few years. In this round, nearly Rs. 50,000 crore investment is expected in setting up of CNG stations and pipelines to take cooking gas to households in 50 towns and cities that were bid out for city gas licence in the 10th round. The management has shown its interest in bidding which would extend to 18 per cent of India's geographical area and 24 per cent of its population. This could be a catalyst for MGL to boost its volumes, going forward.

Risk

- Rupee depreciation would have an adverse impact on MGL's margin

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- Mumbai exclusivity ends in the year 2020, and competition can come in by the way of new players. However, it would be a challenging task for any competitors to replace 5,042 km pipeline network of MGL. Also, there will be switching cost for the customers, all this gives MGL an edge over its competitors.

Financial

From FY13-18, the company's revenue has jumped from Rs. 1,514 crore to Rs. 2,233 crore. Also, during the same period, its PAT has grown to Rs. 478 crore in FY18 from Rs. 299 crore in FY13.

In the recently concluded quarter (Q3FY19), Mahanagar Gas posted a good set of numbers, its revenue for the quarter grew nearly 29 per cent yoy to Rs. 824.3 crore. In Q3FY19, Mahanagar Gas came up with positive volume surprise, growth of 8.1 per cent yoy which is a bit higher than the company's average growth rate of 6-6.5 per cent. This growth was led primarily by high CNG volumes at 2.17 mmscmd, up by 8.3 per cent yoy.

EBITDA for Q3FY19 grew around 19 per cent yoy to Rs. 239.1 crore. But higher input prices led to EBITDA margin contraction of 248 bps yoy to 29.01 per cent. Net profit during the quarter surged almost 20 per cent yoy to Rs. 148.3 crore.

Valuation and Outlook

City Gas Distribution business is monopolistic in nature due to allotment of license for specified region and cities. Gujarat Gas has its exclusive presence in Surat, Bharuch and Ankleshwar. Indraprastha Gas in Delhi, Ghaziabad, Noida & Greater Noida and Mahanagar Gas for Mumbai, Thane, Mira Bhayandar and Navi Mumbai.

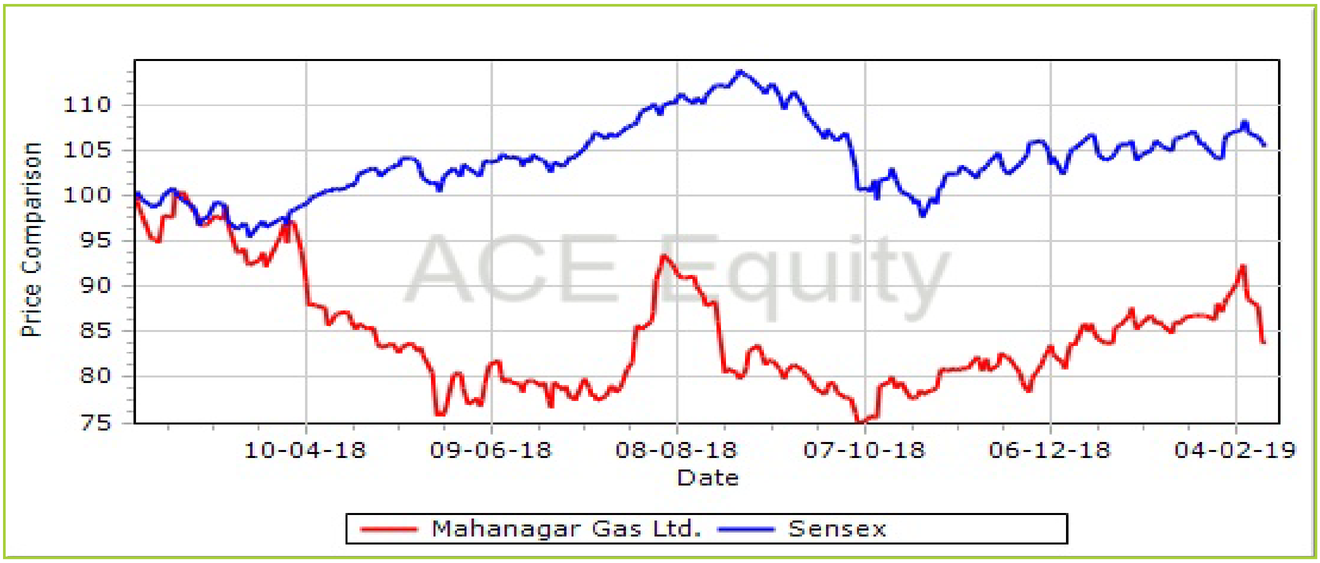
Despite the business involving in an asset-heavy model, the company has no debt on its book and over the past year, the company has maintained consistency in dividend payout (around average 50 per cent in last 6 years). Further, Mahanagar Gas boast of healthy return ratios, 36.9 per cent of ROCE and 24.3 of ROE in FY18. While its peer Indraprastha Gas command 30.83 per cent and 20 per cent ROCE and ROE. In terms of valuations, the stock of Mahanagar Gas is presently available at discounted P/E multiple of 16.7 on TTM earnings as against five-year median P/E 17.6x. Its peers Indraprastha Gas and Gujarat Gas are currently trading at P/E multiple at 25.62 and 23.5, respectively. Owing to all these, we urge our investors to BUY this scrip, keeping in mind a potential target of Rs. 1045 per share, an upside of almost 20 per cent.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	2233.01	2033.97	2078.30	2094.93	1885.15
Total Income	2290.69	2087.95	2125.48	2135.64	1919.65
Total Expenditure	1452.90	1391.14	1569.01	1605.23	1396.94
PBIDT	837.79	696.81	556.46	530.41	522.71
PAT	477.87	393.43	310.89	301.00	297.25
Dividend %	190.00	190.00	175.00	175.00	175.00
Adj. EPS(Rs)	48.38	39.83	34.80	33.69	33.27

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201812	201809	Q on Q Var%	201712	Y on Y Var%
Net Sales	824.34	762.94	8.05	638.25	29.16
Total Expenditure	585.24	541.47	8.08	437.26	33.84
PBIDT (Excl OI)	239.10	221.47	7.96	200.99	18.96
PAT	148.32	136.29	8.83	123.98	19.63
PBIDTM% (Excl OI)	29.01	29.03	-0.07	31.49	-7.88
PBIDTM%	31.48	31.41	0.22	33.69	-6.56
PATM%	17.99	17.86	0.73	19.42	-7.36
Adj. EPS(Rs)	15.02	13.80	8.84	12.55	19.68



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