HDFC securities

Equity Research

Pick of the week

RETAIL **DESK**

HDFC securities

MAHANAGAR GAS LTD

PICK OF THE WEEK
Aug 14, 2017

Industry	CMP	Recommendation	Add on dips to	Sequential Targets	Time Horizon
Gas distribution	Rs. 986	Buy at CMP and add on declines	Rs. 890-910	Rs. 1078-1158	4-6 Quarters

HDFC Scrip Code	MAHGASEQNR
BSE Code	539957
NSE Code	MGL
Bloomberg	MAHGL IN
CMP Aug 11 2017	Rs. 986
Equity Capital	98.8
Face Value (Rs)	10.0
Eq- Share O/S(crs)	9.9
Market Cap (Rs crs)	9739.5
Book Value (Rs)	186.3
Avg.52 Wk Volume	43562
52 Week High	1088.5
52 Week Low	530.0

Shareholding Pattern % (June 30, 17)	
Promoters	65.0
Institutions	17.2
Non	17.8
Total	100.0

FUNDAMENTAL ANALYST
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Mahanagar Gas Ltd (MGL) is one of the India's leading Natural Gas Distribution Companies. MGL is engaged in supplying natural gas in Mumbai and is presently the sole authorized distributor of compressed natural gas (CNG) and piped natural gas (PNG) in Mumbai, its adjoining areas and the Raigarh district in the state of Maharashtra. MGL is a joint venture between GAIL (India) Ltd and the BG Group, (U.K.) - both together hold 65% (32.5% each) of equity.

Investment Rationale:

- Well positioned as sole authorized distributor of CNG and PNG in Mumbai – ever expanding customer base coupled with large unserved population provides a strong growth opportunity.
- It is in the process of expanding the CGD network in the Geographic Area of Raigarh District with 300 months of infrastructure exclusivity and 60 months of marketing exclusivity commencing wef April 01, 2015.
- Strong parentage – GAIL and Shell (BG) – having deep understanding of gas business,
- Sourcing and cost advantage for NG could boost its margins.
- Gas Prices likely to remain subdued even longer than crude – which is good for the company.
- Strong financial profile with healthy profitability and return indicators.

Concerns:

- Large dependence on CNG business.
- Spread between PNG and alternate fuel prices could narrow resulting in slowdown in growth rate.
- Geo political issues.
- Competition with other existing players in Maharashtra especially in the industrial and commercial segments.
- Ongoing expansion/capex plans could subdue return indicators due to the gestation period associated with build-up of sales volume and long lead time required to get regulatory approvals for laying the network.

View and Valuation:

MGL is in a sweet spot given the existing large customer area and the new area (Raigarh district), modest penetration in the existing areas, favourable feedstock allocation and gas pricing, strong financial profile, strong free cash flows and strong return ratios. Markets could gradually correct the under pricing that it is giving to MGL currently.

Though the volume numbers for the latest quarter have been subdued, we think this could be one-off, and the volume growth trajectory could resume soon.

We feel investors could buy the stock at the CMP and add on dips to Rs. 890-910 band (14.0x FY19E EPS) for sequential targets of Rs 1078 (16.75x FY19E EPS) and Rs 1158 (18.0x FY19E EPS). At the CMP of Rs 986 the stock trades at 15.3x FY19E EPS.

KEY HIGHLIGHTS

- ***Mahanagar Gas Ltd (MGL) is one of the India's leading Natural Gas Distribution Companies.***
- ***MGL 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, its adjoining areas and the Raigarh district in the state of Maharashtra, India.***
- ***As at March 31, 2017, MGL had a supply network of over 4,838 kms of pipelines.***
- ***Demand growth in both the CNG and PNG segments, given the price differential between gas and liquid fuels apart from other advantages such as ease of handling, no storage requirement, and credit period provide favourable outlook for MGL.***

Financial Summary:

Particulars (Rs cr)	Q1FY18	Q1FY17	YoY-%	Q4FY17	QoQ-%	FY16	FY17	FY18E	FY19E
Total Income from Opert-	530.9	483.4	9.8%	525.3	1.1%	2078.9	2034.0	2385.6	2675.3
EBITDA	203.3	152.4	33.4%	163.1	24.6%	509.9	644.2	808.3	912.2
APAT	124.3	92.7	34.1%	99.5	25.0%	311.5	393.4	507.6	584.0
Diluted EPS (Rs)	12.6	9.4	34.1%	10.1	25.0%	34.9	39.8	51.4	59.1
P/E (x)						28.3	24.8	19.2	16.7
EV / EBITDA (x)						16.9	14.9	11.9	10.5
RoE-%						18.0%	21.4%	23.4%	23.6%

Source: Company, HDFC sec)

Company Profile:

Mahanagar Gas Ltd (MGL, established on 8th May, 1995) is one of the India's leading Natural Gas Distribution Companies. MGL 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, its adjoining areas and the Raigarh district in the state of Maharashtra, India. MGL is a joint venture between GAIL (India) Ltd and the BG Group, (U.K.), both together hold 65% (32.5% each) of equity. The company made an OFS in July 2016 to provide partial exit to the promoters (pre-IPO stake was 49.75% each). MGL plans to expand its gas distribution network in its current geographical areas (GA), i.e. Greater Mumbai (GA1) and surrounding regions (GA2) such as Mira-Bhayander, Thane (Urban) -Vashi-Belapur, Kharghar-Panvel-Taloja, Kalyan-Dombivali-Ambernath and Ulhasnagar. The company won the bid for Raigarh in the fourth round of bidding conducted by the Petroleum and Natural Gas Regulatory Board (PNGRB) and would be setting up its city gas distribution (CGD) network in the district (GA3). The company procures natural gas primarily from GAIL (India) Limited.

MGL distributes CNG for motor vehicles and PNG for domestic household use as well as for commercial and industrial use. MGL supplies PNG to 0.97mn households, over 2800 small commercial establishments and 60 industrial establishments. It also supplies CNG to more than 0.55 mn vehicles in Mumbai, Thane, Mira Bhayander and Navi Mumbai. It has 206 CNG filing stations. MGL has achieved a track record of almost 100% reliability in its gas supply. For FY17, its CNG and PNG businesses accounted for ~74% and ~26%, respectively, of the total volume of natural gas sold.

As at March 31, 2017, MGL had a supply network of over 4,838 kms of pipelines and 206 CNG filling stations.

Key Promoters:

GAIL India Ltd:

GAIL is India's largest natural gas company having a market share of over 80% in natural gas transmission and holds 32.5% stake of MGL. GAIL has diversified business interest in LPG transmission, petrochemicals, city gas distribution projects and exploration and production activities. GAIL owns more than 11,000 km of natural gas pipeline transmission network. GAIL has presence in Egypt and China through city gas projects and in Myanmar through E&P.

BG Asia Pacific Holdings Pte. Ltd (BGAPH):
BGAPH is the wholly owned subsidiary of BG North Sea Holdings Ltd and holds 32.5% stake of MGL. It is involved in the day to day management of its investments throughout India, Egypt, Mauritius and South East Asia. Through its subsidiaries and associated companies, it is engaged in the business of, amongst others, exploration and production of oil and natural gas, LNG importation and marketing, and transmission and distribution of natural gas.

Business Overview:

Business: (1) Domestic PNG, (2) Commercial PNG (3) CNG (4) Industrial PNG (5) Gas Geysers

Domestic PNG:
MGL is leading and pioneer in natural gas distribution network in Mumbai and its adjoining areas. Over 0.97 million domestic customers are connected through its wide network of over 4800 kms.

Commercial PNG:
MGL connects customers of commercial PNG across a wide network that includes hospitals, hotels, power, charitable trusts and industries.

CNG:
CNG (Compressed Natural Gas) is a fossil fuel substitute for other auto fuels such as petrol, diesel, Auto LPG etc. For use in Automobiles as fuel, Natural Gas is compressed & dispensed to vehicles at high pressure of 200 bar to enhance the vehicle on board storage capacity.

Industrial PNG:
Industrial PNG is used across the all industry for melting, Heat treatment, smelting, fabrication, Moulding Casting, Baking, Steam generation, and process heating, etc. Boiler, Furnace, Kiln, Oven, Thermo pack, VAM, Natural Gas Fired Gensets are common natural gas appliances used in various industries.

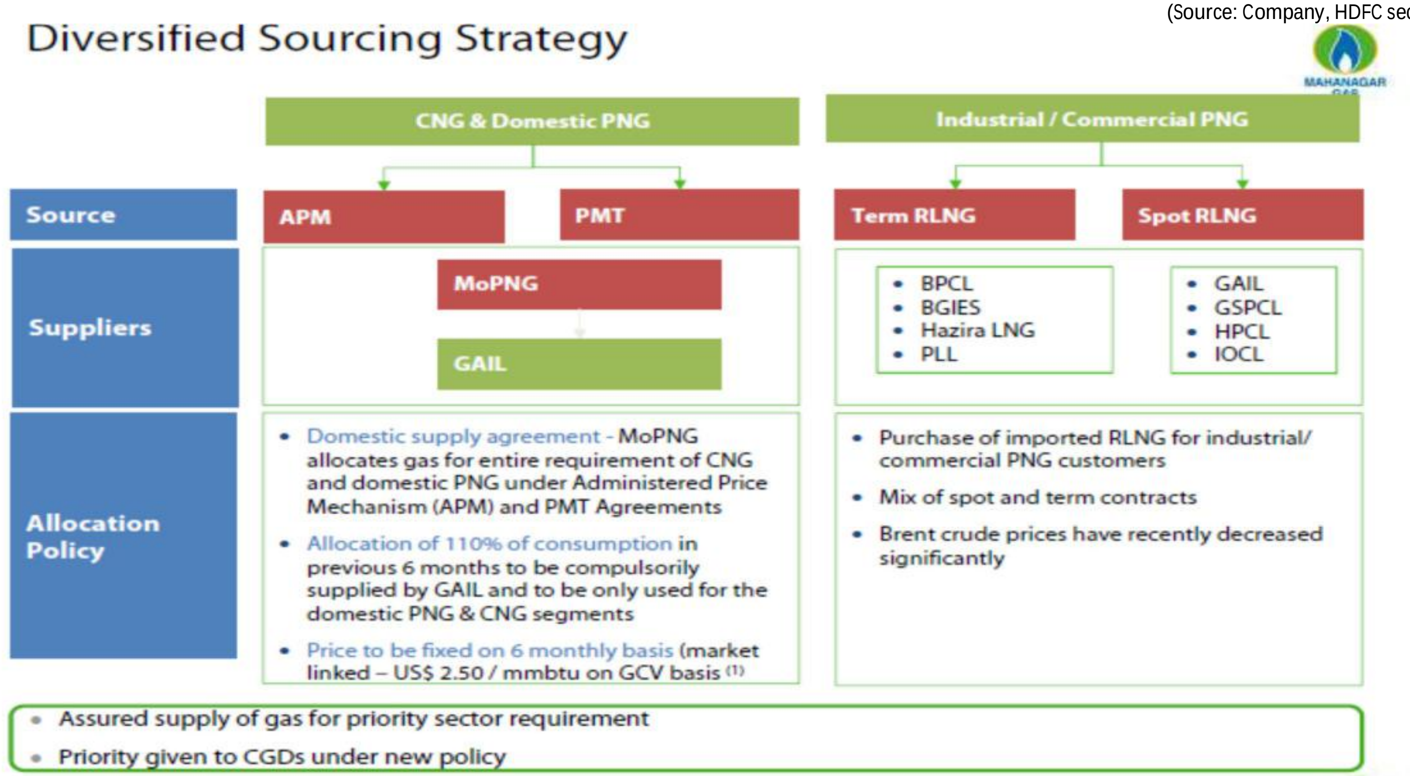
Gas Geysers:
The Instantaneous Water Heaters (i.e. Gas Geysers) is an appliance where the heating of water is directly dependent on the draw off. The appliances shall be manufactured and tested in accordance with all the requirements of IS 15558, or BS EN 26 standards.

Sales Composition (FY17): CNG Sales 73.9%, Domestic PNG 11.8%, Commercial PNG 6.5% and Industrial PNG 7.8%

Business Network:

Areas of Operation	Mumbai & Greater Mumbai	Mira-Bhayander, Navi Mumbai, Thane City, Kalyan, Taloja, Ambernath, Dombivli, Ulhasnagar, Badlapur, Bhiwandi, Kharghar and Panvel	Raigad District (adjacent to existing area of operation)
Population (mn)	20.7 mn population and 3 mn households [1]		
Infrastructure Exclusivity	2020	2030	2040
MGL Pipeline[2]	4,838 kms		
MGL PNG Connections[2]	~ 0.94 mn		
MGL CNG Stations[2]	203		
MGL CNG Customers[2]	~ 0.54 mn		

(Source: Company, HDFC sec)

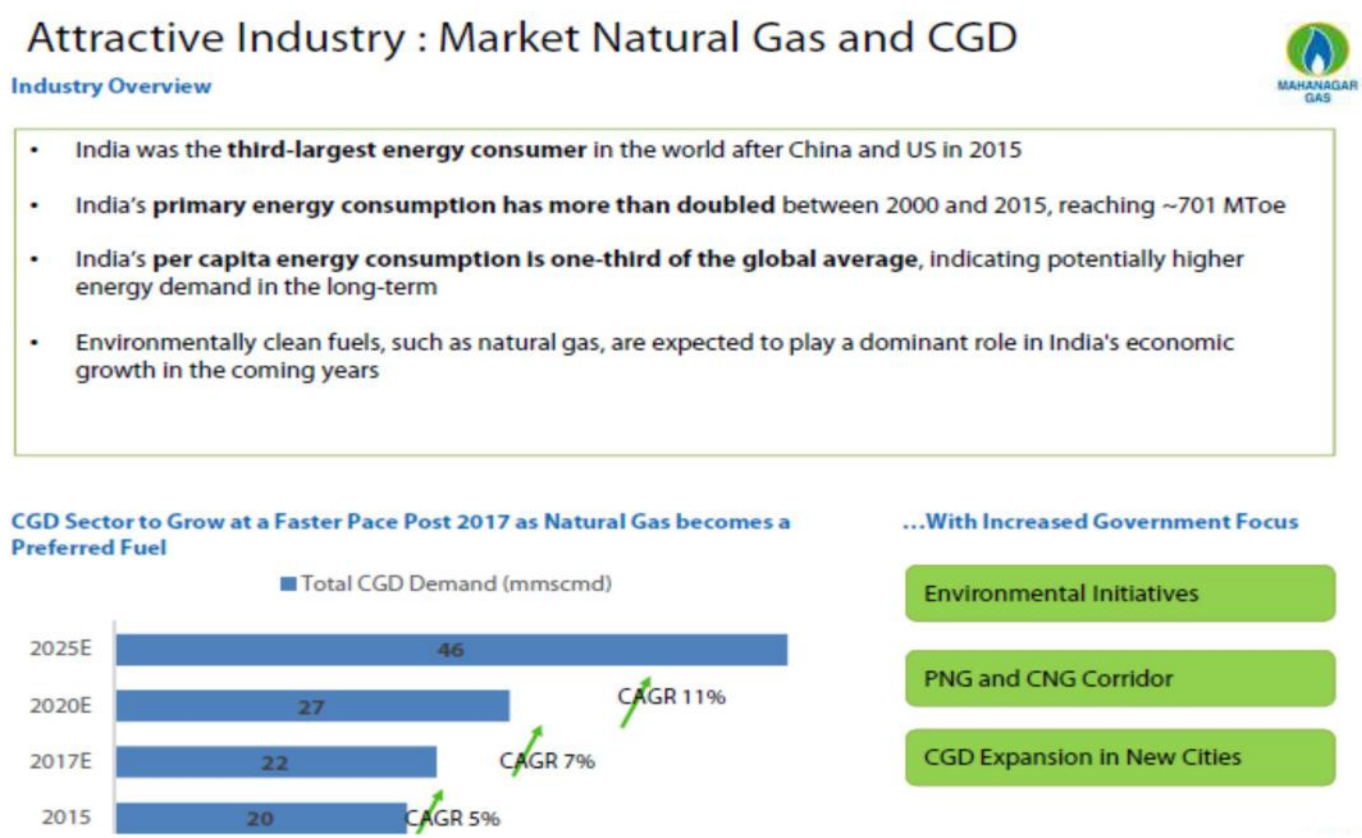


Industry Overview:

The CGD sector comprises of Compressed Natural Gas (CNG) and Piped Natural Gas (PNG) customers, CGD network covers various cities supplying gas for domestic consumers, public transport, and commercial/ industrial entities. The pipeline network has grown at a compound annual growth rate (CAGR) of about 15 per cent between 2012 and 2016 (till June 2016) and the number of CNG stations has increased at a CAGR of 16 per cent. The total sales in 2015-16 were close to 15 mmscmd.

CGD demand is poised for healthy growth over the long term because of;

- Favourable economics of CNG usages compared with the alternative fuels,
- Convenience in use of PNG (domestic) for households,
- Moderate outlook for PNG (industrial) and PNG (commercial) with the likely pick up in manufacturing sector growth,
- Government plans to set up approximately 15,000 kilometres of new gas transmission pipelines would also aid expansion of the CGD into newer areas or Tier-2 and Tier-3 cities,



(Source: Company, HDFC sec)

In 2016, new bidding rounds were rolled out by the PNGRB. Bids were invited for the development of CGD networks for five GAs under the seventh round and another eight Gas (Geographical Areas) under the eighth round. While the seventh round was deferred due to issues of uncertain/distant natural gas pipeline connectivity, the eighth round is currently in its bidding phase.The vacancies in PNGRB have delayed the eighth round of CGD bidding for which the technical bids have already been submitted.

Multiple rounds of bidding for CGD have evoked inadequate response from players in the past. The sixth round of CGD bidding held in 2015 included 34 Geographical Areas, of which only 20 areas received biddings. The seventh round of CGD bidding done to set-up CGD infrastructure in 11 smart cities under smart city mission received only 1 bid.

Commercial success of a CGD venture depends upon the consumer mix including number of passenger vehicles, households, commercial and industrial establishments in a particular geographical area (GA), capex required and competitiveness in gas sourcing.

The government has set a target to provide PNG connections to 10 million households by 2019 and has managed to meet 36 percent of this target up to May 2017, data shows. In total 3.6 million households in the country are connected with PNG. Almost half of these connections are in Gujarat (1.6 million) followed by Maharashtra (1.0 million), New Delhi (0.52 million) and UP (0.27 million).There is thus significant opportunity for CGD operators in the next few years.

New gas pricing formula for domestic gas sales (approved in October 2014) has helped to the sector's growth over the years. The price of natural gas would be the volume weighted average of gas prices at Henry Hub (US), Alberta Gas Reference Point (Canada), National Balancing Point (NBP) (UK) and the Russian domestic market. Gas prices will be determined on a half-yearly (April and October) basis and based on trailing four quarter prices at these hubs, with a one quarter lag.

In order to promote CNG (transport) and PNG (domestic) and for a developed CGD sector in the country, Ministry has taken a decision to meet 100% requirement (to the maximum extent possible) of CNG (transport) and PNG (domestic) of all CGD entities across the nation without any discrimination amongst entities.

The Ministry is formulating guidelines relating to grant of rights to entities for sale of CNG as transportation fuel through CNG Stations. The intent of the envisaged guidelines is to promote setting up of several CNG stations in various cities/towns across the country, including along highways, and also to foster competition amongst eligible entities in the CNG segment, analogous to that in liquid transportation fuel (MS, HSD and ATF) segment. This would lead to faster rollout of large number of CNG stations across the nation.

Investment Rationale:

Well positioned as sole authorized distributor of CNG and PNG in Mumbai:

MGL is the sole authorized distributor of CNG and PNG in Mumbai (one of the most populous city in the world and second largest metropolitan city in India), its surrounding areas and its adjoining area and Raigarh district of Maharastra. Mumbai, being a growing commercial and financial hub, provides additional opportunities to capture the demand for natural gas from domestic customers and the commercial sector owing to its increasing population and growth of commercial establishments including restaurants and QSRs. We believe, MGL is strategically positioned to capture the benefits of this large and growing market given the low penetration in its areas of operation. The ever expanding customer base coupled with large unserved population provides a strong growth opportunity.

MGL has monopoly position in Greater Mumbai (GA1) and surrounding expansion areas (GA2) and its diversified customer profile. MGL could continue to enjoy a dominant market share because of its first-mover advantage, as evident from its established infrastructure network. In addition, there are significant entry barriers for third-party marketers arising mainly from concerns regarding availability of gas at competitive prices. MGL continues to enjoy physical exclusivity (25 years from the year 1995 for Greater Mumbai and from 2005 for expansion areas, which can be further extended for a block of 10 years) which is another positive for the company's operations.

After the expiry of the marketing exclusivity, the company was required to make its network available to third-party marketers on an open-access basis. The company, however, enjoys physical exclusivity in GA1 and GA2 for 25 years from 1995 and 2005, respectively. While the expiry of marketing exclusivity, in principle, would imply an increase in competition for MGL, the actual competitive risk is expected to be fairly limited due to the company's first-mover advantage, established network and customer relationships, and security of existing gas supplies. Any third-party marketer looking to utilise the infrastructure of MGL for CNG/PNG sales is faced with multiple operational challenges and constraints related to regulatory uncertainty.

MGL is in the process of expanding the CGD network in the Geographic Area of Raigarh District:

MGL plans to expand its gas distribution network in its current geographical areas (GA), i.e. Greater Mumbai (GA1) and surrounding regions (GA2) such as Mira-Bhayander, Thane (Urban) -Vashi-Belapur, Kharghar-Panvel-Taloja, Kalyan-Dombivali-Ambernath and Ulhasnagar.

MGL is in the process of expanding the CGD network in the Geographic Area of Raigarh District (Maharashtra) authorized by the PNGRB with 300 months of infrastructure exclusivity and 60 months of marketing exclusivity commencing w.e.f. April 01, 2015.

The company won the bid for Raigarh in the fourth round of bidding conducted by the Petroleum and Natural Gas Regulatory Board (PNGRB) and would be setting up its city gas distribution (CGD) network in the district (GA3). This would involve large scale of capex (~Rs. 1,000 crore over 25 years) with build-up of sales volumes in Raigarh expected to be gradual.

MGL won CGD development bid Raigarh in 2015, wherein the Raigarh district covers large industrial base ofchemicals, pharmaceuticals, iron & steel, engineering products, plastics and food & agro products industries catering to Mumbai and exports markets. MGL plans to connect 6-7 industrial clusters in future. MSME in the Raigarh region could have 0.9mmscmd gas demand potential for which the company needs to work on implementation of network pipeline infrastructure. However, the Raigarh region is thinly populated and thus would give lower demand growth potential from CNG and household PNG segments. Supply in Raigarh by MGL has commenced in June 2017. MGL has also identified sites on the Mumbai-Pune Expressway and will install CNG dispensers in existing OMC stations along the highway.

Raigarh has an advantage due to its nearness to Dabhol-Panvel and Dahej-Uran pipelines,which give ease in access to LNG from Dahej and Dabhol re-gasification terminals at competitive gas transmission rates.

Strong parentage – GAIL and Shell (BG) – having deep understanding of gas business

GAIL and BG Asia Pacific Holdings Pte Ltd are promoters of MGL, holding 32.5% equity stake each in the company. The company made its OFS in July 2016 to provide partial exit to the promoters (pre-IPO stake was 49.75% each). GAIL is India's largest natural gas company having a market share of over 80% in natural gas transmission.Through its subsidiaries and associated companies, BG Asia Pacific Holdings Pte Ltd (BGAPH) is engaged in the business of exploration and production of oil and natural gas, LNG importation and marketing, and transmission and distribution of natural gas.

Both these promoters have deep understanding of Gas markets which will enable MGL to take advantage of emerging opportunities in the space.

Sourcing and cost advantage for NG could boost its margins:

A key driver for the demand for natural gas is its cost advantage compared to alternate fuels. The price at which MGL sells natural gas is benchmarked to the price of alternate fuels as petrol, diesel, other liquid fuel and LPG. Prices of alternate fuels are linked to the price of crude oil. In the past, international crude prices had increased significantly with Brent crude reaching US$ 128.14 per barrel as of March 13, 2012. Now crude oil prices are moving up from its low and trading at $48-50 per barrel. We think crude price will remain at a range of $50-$60/barrel in near to medium term, therefore we expect small price rise in Petrol, Diesel and fuel oils. The outlook on gas prices is however soft and hence this difference could result in continued demand growth for CNG/PNG apart from the other advantages such as ease of handling, no storage requirement, and credit period are favourable outlook for MGL.

The decline in global gas indices led to a decline in gas cost for the CGD sector with domestic gas prices announced by the Government of India for the six-month period starting from April 1, 2017 being lower by about 20% compared to the prices announced for the six-month period starting from April 1, 2016. MGL has passed on partially the benefit of lower gas costs to its customers leading to lower gas prices and therefore higher cost advantage against alternate fuels.

Attractive Fuel Economics

CNG Retains its Price Competitiveness vs. Other Fuels
Comparison of Alternative Fuel Costs

Particulars	INR / kg or INR / L
CNG	40.82
Diesel	60.47
Petrol	76.55

32% differential
63% differential

Commercial PNG Favorably Priced vs. Alternate Fuels

Particulars	UoM	
PNG	INR/SCM	28.94
Light Diesel Oil	INR/Ltr	32.88
Commercial LPG	INR/Kg	54.86

-14% differential
-37% differential

- **Price Advantage**
  Natural gas provides economic benefits over most alternative liquid fuels
- **Fuel Efficiency**
  CNG vehicles typically enjoy higher fuel efficiency
- **Payback Period**
  Lower running costs result in lower payback period and savings

PNG Provides Savings with respect to Non-subsidized LPG

Energy Cost for Cylinders (INR / Mn Kcal)	Number of Subsidized Cylinders 12	9	6	0
LPG	3101	3361	3621	4141
PNG	2873	2873	2873	2873
% Difference	7%	15%	21%	31%

With gradual phasing out of subsidized LPG cylinders by Government, consumers will be incentivized to purchase PNG due to significant savings

(Source: Company, HDFC sec)

Apart from this, verdict on July 1, 2015 in favour of Indraprashta Gas Limited (IGL) in its dispute with the PNGRB has helped alleviate the regulatory risks that the sector was facing. The ruling provides pricing freedom (including network tariffs and compression charges) to CGD players operating through their own network thereby assuring stability in margins and viability of gas distribution operations.

A favourable allocation policy has assured availability of gas from GAIL for CNG and PNG-domestic segments. In February 2014, the GoI announced allocation of 100% domestic gas towards the CNG and PNG (domestic) segments of CGD entities, up from the initial 80% proportional allocation. Further, in August 2014, the MoPNG issued another guideline as per which GAIL was directed to supply an additional 10% to meet incremental demand during the review period of the CNG and PNG (domestic) segments over and above the 100% allocated gas (based on past six months consumption). The above step was a positive to increase the penetration levels in the CNG and PNG-domestic market, with the assurance of extending domestic gas allocation to such increased volumes.

The ability to source market priced gas from all major sources through physical connectivity with GAIL's Dahej-Uran pipeline network is an added advantage enjoyed by MGL.

Gas Prices are likely to remain subdued:

There is an excess of crude oil in the market. The OPEC cartel doesn't have the force it used to have, most producing companies are looking at maximizing revenue while demand is subdued in US, Europe and China. India is chugging along with demand increasing at the same levels as it did before. With all these factors at play and newer producers coming in, the availability of crude oil and natural gas has gone up considerably and demand has not kept pace with supply. This sort of a trend will take time to reverse and, if this is anything to go by, crude prices are likely to remain subdued. In the next year or so, crude prices could remain in a band of $10-12 from where it is now. Gas prices will be much more subdued, with a lot more gas produced in US and demand falling in traditional guzzlers like Japan and Korea. Consumption in other countries hasn't picked up in the manner they were expected to, so gas prices will remain subdued even longer than crude. It is good for CGD companies in India; subdued gas prices could create more demand and more business opportunities in India.

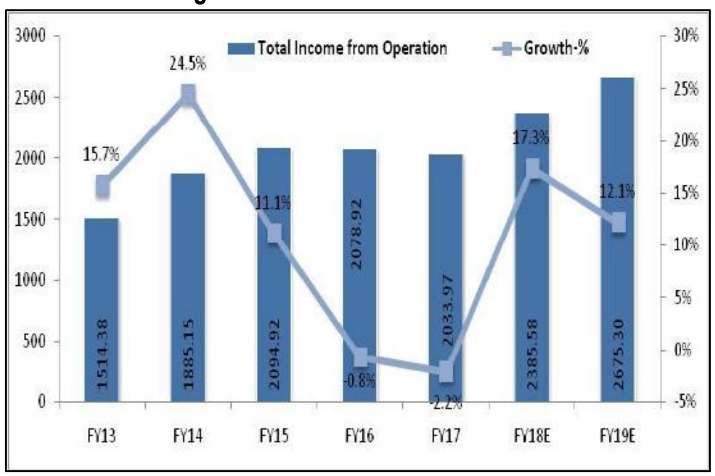
MGL has a plan to set up CNG stations with 20-25 additions in FY18E, it has already set up 3 stations in Q1FY18.

In the next five years, MGL has plans to increase its customer base to about 10 lakh households, operate about 330 CNG stations, and expand the steel pipeline network to around 600 kms, and the PE pipeline network to over 5500 kms. In MMR (Mumbai Metropolitan Region), every year Company is likely to lay about 30-40 km of steel and 100 km of PE (polyethylene) pipelines. They already have 4,700 km of network in MMR and going to take up Raigarh district now where instead of building a grid. Apart o this, company is looking at creating nodes or clusters and pipelines heading out from these. Instead of creating an entire grid and meshing it up, this method will make the rollout faster.

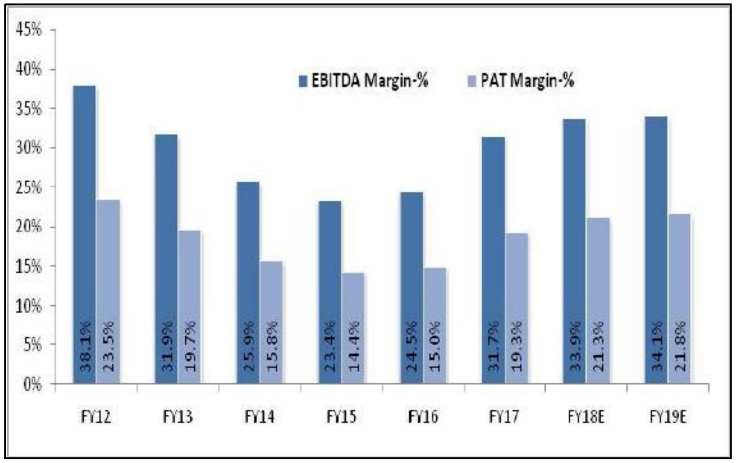
The capex plans of MGL entail an outlay of Rs.250-275 cr in FY18 and FY19 each.

Strong financial profile with healthy profitability and return indicators:

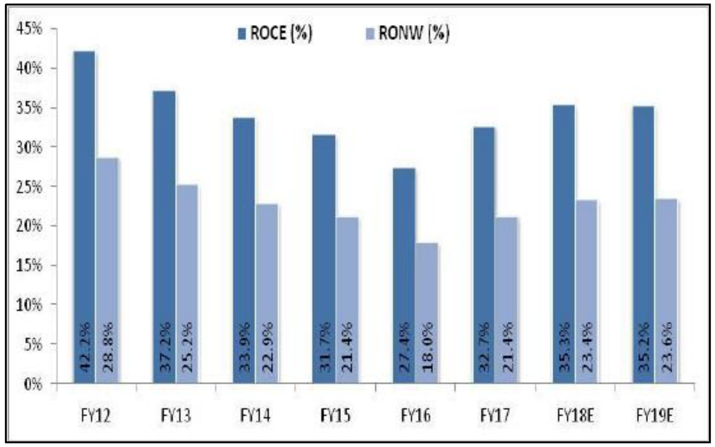
Sales and Sales growth-%



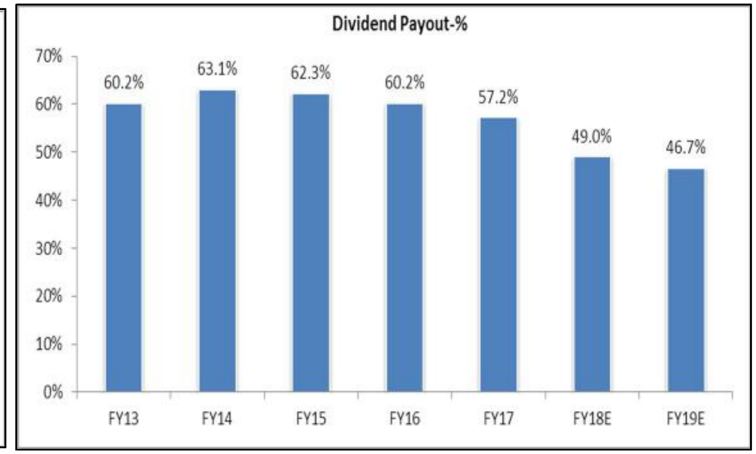
Margin-%



Return Ratio-%



Payout-%



(Source: Company, HDFC sec)

We believe that the company is likely to maintain its current EBITDA margins of 31-34% given increasing penetration and cost benefits for consumers. It's a debt free company and has been paying consistent dividend, maintain payout at ~57% mark. MGL has healthy return ratios as well with ROCE of ~33% and ROE of ~21% in FY17. It's a cash rich company with free cash flows for all past 5 years.

Taking into the consideration of recent management discussion, company has no intention to add further term debt in near future. Apart of this, company is very good on dividend payments (last dividend 190% for FY17).

Q1FY18 Results Review:

Volumes increased 2.7% YoY to 2.6 mmscmd. CNG volumes grew a mere 1.4% YoY(in kg, up 4.4% YoY) and were at 1.88 mmscmd(due to vacation season) whereas PNG volumes grew 6.7% YoY and were at 0.68 mmscmd. Gross margins were at Rs.15.1/scm on account of lower raw material costs (mainly due to lower spot gas prices and favourable exchange rate).

Volume growth, going ahead, may be better given steady conversion rate of vehicles to CNG (5000-6000 per month) and MGL's plans to aggressively set up CNG stations with 20-25 additions in FY18E (50% company-owned, which typically generate higher throughput and better margin). It plans to add 1.4 lakh households in FY18E.

Risk and Concerns:

Largely depends on CNG business:

For Fiscal 2014, Fiscal 2015, Fiscal 2016 and and FY17, the sale of CNG accounted for 61.82%, 65.10%, 71.05% and 73% respectively, of MGL's total gas sales revenue. Any decrease in the volume of CNG sold, due to factors which may not be in company's control or otherwise, may have an adverse effect on its business, results of operations, financial condition and cash flows.

Spread between PNG and alternate fuel prices could narrow resulting in slowdown in growth rate.
If the spread between Gas prices and liquid fuels narrow, then the attractiveness of CNG/PNG would reduce impacting the growth rate of demand.

Fuel Oil(FO) is surplus in the domestic market, which results in discounts offered by domestic refiners to avoid export cost for selling FO outside India. Subsequently, domestic refiners could sell FO in the domestic market at USD 2.0-4.0/mmbtu lower price than import parity price,which is import parity price less import cost and less potential export charges.

Ability to tie up new gas sources at competitive prices would be critical to sustain the profit margins for PNG-Industrial and Commercial segments.

Breakdown/leakagesor supply disruptions:
MGL receives natural gas from city gate stations located at Wadala, Mahape, Ambernath and Taloja through pipelines owned by GAIL. The natural gas is then distributed through MGL's network of pipelines to CNG filling stations and PNG consumers. In the event that company suffers an interruption in the receipt of natural gas, its supllies to its customers could get disrupted. On March 30, 2017, PNG supply to houses in Kandivli, Borivli, Dahisar, Mira Road and Bhayander had been disrupted following damage to MGL pipeline.

Delays in commissioning new CNG filling stations:
Company is in the process of acquiring or leasing land for CNG filling station. Any delay on land acquisition and setting up filling terminal could impact its operation and cash flow going forward.

Ongoing expansion/capex plans could subdue return indicators due to the gestation period associated with build-up of sales volumeand long lead time required to get regulatory approvals for laying the network
MGL could face delays in meeting the initial targets for the Raigarh expansion due to delay in approvals from multiple regulatory bodies as the concerned area lies in an eco-reserve. The Raigarh region is thinly populated and thus could give minimaldemand growth potential from CNG and household PNG segments. The ramp-up of Raigarh CGD operations to attainmeaningful industrial gas sales would require at least three years. Till that time the return on the investment could depress the overall return ratios for the company.

Competition with other existing player at Maharashtra:
Maharashtra Natural Gas Limited (MNGL) incorporated in January 2006, has got the PNGRB authorization for city gas distribution in Pune & Pimpri-Chinchwad city including adjoining areas of Hinjewadi, Chakan &Talegaon and subsequently will move on to other districts of Maharashtra depending on economic feasibility.

MNGL is a joint venture Company of two navratna PSUs viz. Bharat Petroleum Corporation Limited (BPCL) and GAIL (India) Limited, (GAIL) with the mission to supply clean and green (eco-friendly) fuel. MNGL caps the geographical presence of MGL in Maharashtra, Pune is one of the growing city in India, but MGL is unable to enter due the gas sharing agreement under the guidance of PNGRB.

Threat from potential competition, especially in the industrial and commercial segments, remains a possibility after the end of the company's marketing exclusivity in GA1 in 2012 and GA2 in 2014; however, no new player has emerged so far.

View and Valuation:

MGL is in a sweet spot given the existing large customer area and the new area (Raigarh district), modest penetration in the existing areas, favourable feedstock allocation and gas pricing, strong financial profile, strong free cash flows and strong return ratios. Markets could gradually correct the under pricing that it is giving to MGL currently.

Though the volume numbers for the latest quarter have been subdued, we think this could be one-off, and the volume growth trajectory could resume soon.

We feel investors could buy the stock at the CMP and add on dips to Rs. 890-910 band (14.0x FY19E EPS) for sequential targets of Rs 1078 (16.75x FY19E EPS) and Rs 1158 (18.0x FY19E EPS). At the CMP of Rs 986 the stock trades at 15.3x FY19E EPS.

Quarterly Financials –

Particulars (Rs cr)	Q1FY18	Q1FY17	YoY-%	Q4FY17	QoQ-%
Total Income from Operation	530.86	483.44	9.8%	525.33	1.1%
Stock Adjustment	0.01	0.04	-75.0%	0.01	0.0%
Purchase of Finished Goods	231.19	245.44	-5.8%	260.75	-11.3%
Employee Expenses	17.46	14.61	19.5%	16.04	8.9%
Other Expenses	78.94	71	11.2%	85.4	-7.6%
Total Expenditure	327.6	331.09	-1.1%	362.2	-9.6%
EBITDA	203.26	152.35	33.4%	163.13	24.6%
Depreciation	24.63	21.61	14.0%	25.68	-4.1%
EBIT	178.63	130.74	36.6%	137.45	30.0%
Other Income	12.01	12.33	-2.6%	12.95	-7.3%
Interest	0.2	0.53	-62.3%	-0.07	-385.7%
EBT	190.44	142.54	33.6%	150.47	26.6%
Tax Paid	66.11	49.81	32.7%	51	29.6%
Reported Profit After Tax	124.33	92.73	34.1%	99.47	25.0%
Adjusted Profit After Extra-ordinary item	124.33	92.73	34.1%	99.47	25.0%
EPS	12.59	9.39	34.1%	10.07	25.0%

(Source: Company, HDFC sec)

Financials:

Income Statement

Particulars, Rs in Cr	FY15	FY16	FY17	FY18E	FY19E
Total Income from Operation	2094.9	2078.9	2034.0	2385.6	2675.3
Cost of Nat- Gas and Traded Items	1295.8	1229.6	1018.4	1174.1	1323.1
Changes in Inventories	-0.1	0.1	0.0	0.0	0.0
Employee benefits expense	51.1	56.3	60.0	69.2	76.2
Other expenses	258.4	283.0	311.4	334.0	363.8
Total expenses	1605.2	1569.0	1389.8	1577.3	1763.1
EBITDA	489.7	509.9	644.2	808.3	912.2
Growth-%	*0.3%*	*4.1%*	*26.3%*	*25.5%*	*12.9%*
EBITDA Margin-%	*23.4%*	*24.5%*	*31.7%*	*33.9%*	*34.1%*
Dep- and amort- exp	79.9	82.6	95.1	101.3	106.4
EBIT	409.8	427.3	549.0	707.0	805.7
Other Income	40.7	47.2	52.7	57.3	66.9
Finance Costs	1.2	2.2	1.0	0.9	1.0
Earnings before Tax	449.3	472.3	600.7	763.3	871.7
Tax expense:	148.3	160.7	207.2	255.7	287.6
Tax rate-%	*33.0%*	*34.0%*	*34.5%*	*33.5%*	*33.0%*
PAT	301.0	311.5	393.4	507.6	584.0
Growth-%	*1.2%*	*3.5%*	*26.3%*	*29.0%*	*15.1%*
PAT Margin-%	*14.4%*	*15.0%*	*19.3%*	*21.3%*	*21.8%*
EPS	33.7	34.9	39.8	51.4	59.1

Cash Flow

Particulars, Rs in Cr	FY15	FY16	FY17	FY18E	FY19E
EBT	449.3	468.6	600.7	763.3	871.7
Depreciation and Amort-	79.9	84.1	95.1	101.3	106.4
Interest /Dividend paid	1.2	5.9	1.0	0.0	0.0
Other Adjustment	-30.7	123.7	-32.2	-26.5	-28.0
(Inc)/Dec in working Capital	66.0	47.1	77.4	-35.9	-76.1
Tax Paid	-139.0	-150.1	-207.2	-255.7	-287.6
CF from Operating Activities	426.7	579.4	534.8	546.5	586.4
Capital expenditure	-197.6	-221.1	-296.6	-220.0	-210.0
Proceeds from sale of f.a	0.1	0.1	0.2	0.2	0.1
(Purchase)/Sale of Invest	-27.8	-12.7	-73.3	-140.0	-151.7
Others	-35.4	5.1	37.1	39.6	47.6
CF from Investing Activities	-260.7	-228.6	-332.6	-320.3	-314.0
Inc/(Dec) in Share capital	9.4	0.0	0.0	0.0	0.0
Inc/(Dec) in Debt	-1.8	-1.8	-1.7	-1.0	1.5
Dividend and Interest Paid	-183.7	-189.7	-227.4	-249.9	-273.6
CF from Financing Activities	-176.1	-191.4	-229.1	-250.9	-272.1
Net Cash Flow	-10.1	159.3	-26.9	-24.7	0.3
Opening Balance	25.8	15.7	175.0	148.1	123.4
Closing Balance	15.7	175.0	148.1	123.4	123.7

(Source: Company, HDFC sec)

Balance Sheet

Particulars, Rs in Cr	FY15	FY16	FY17	FY18E	FY19E
EQUITY AND LIABILITIES					
Share Capital	89.3	89.3	98.8	98.8	98.8
Reserves and Surplus	1318.1	1639.1	1741.3	2066.0	2377.4
Shareholders' Funds	**1407.5**	**1728.4**	**1840.0**	**2164.8**	**2476.1**
Long-term borrowings	15.6	4.4	2.7	1.7	3.2
Deferred tax liabilities (Net)	102.7	120.0	137.6	126.6	120.3
Other long-term liabilities	1.1	0.5	0.2	0.2	0.2
Long-term provisions	6.8	11.2	14.0	14.7	16.2
Non-current liabilities	**126.2**	**136.0**	**154.5**	**143.2**	**139.9**
Trade payables	112.0	111.6	149.0	156.9	153.9

Key Ratios

Particulars	FY15	FY16	FY17	FY18E	FY19E
No of Equity Shares-cr	8.9	8.9	9.9	9.9	9.9
Enterprise Value-cr	8679.8	8638.5	9594.1	9617.8	9619.0
EPS	33.7	34.9	39.8	51.4	59.1
Cash EPS (PAT + Depr)	42.6	44.1	49.5	61.6	69.9
Book Value Per Share(Rs.)	157.5	193.5	186.3	219.2	250.7
PE(x)	29.3	28.3	24.8	19.2	16.7
P/BV (x)	6.3	5.1	5.3	4.5	3.9
Mcap/Sales(x)	4.1	4.2	4.7	4.0	3.6

Other current liabilities	322.7	382.8	466.0	396.1	356.5
Short-term provisions	197.3	11.6	14.8	15.5	14.7
Current liabilities	**631.9**	**506.1**	**629.7**	**568.4**	**525.1**
Total	***2165.6***	***2370.5***	***2624.3***	***2876.4***	***3141.1***
ASSETS					
Fixed assets	**1443.6**	**1557.6**	**1716.3**	**1835.0**	**1938.6**
Long-term loans and adv	29.6	29.1	30.5	32.0	35.2
Other non-current assets	1.8	44.8	81.5	85.6	89.9
Non-current assets	**1475.0**	**1631.4**	**1828.3**	**1952.7**	**2063.7**
Current investments	371.5	393.4	466.7	606.7	758.3
Inventories	17.4	18.0	23.8	26.1	22.0
Trade receivables	96.2	92.3	94.5	104.6	109.9
Cash and cash equivalent	144.9	175.0	148.1	123.4	123.7
Short-term loans and adv	30.6	42.1	40.9	38.8	36.9
Other Current assets	29.9	18.2	22.0	24.2	26.6
Current assets	**690.5**	**739.0**	**795.9**	**923.8**	**1077.4**
Total	***2165.6***	***2370.5***	***2624.3***	***2876.4***	***3141.1***

EV/EBITDA	17.7	16.9	14.9	11.9	10.5
EBITDAM (%)	23.4%	24.5%	31.7%	33.9%	34.1%
EBITM (%)	19.6%	20.6%	27.0%	29.6%	30.1%
PATM (%)	14.4%	15.0%	19.3%	21.3%	21.8%
ROCE (%)	31.7%	27.4%	32.7%	35.3%	35.2%
RONW (%)	21.4%	18.0%	21.4%	23.4%	23.6%
Current Ratio	1.1	1.5	1.3	1.6	2.1
Quick Ratio	1.1	1.4	1.2	1.6	2.0
Debt-Equity	0.0	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)

Daily Closing Price Chart (Since listing)

(Source: Company, HDFC sec)

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