Dimensional Securities Pvt Ltd.

Mahanagar Gas Ltd. - IPO Note

Date: 20th June, 2016
Recommendation: Subscribe
Target: ₹575

Issue Details	
Issue Dates	21st June to 23rd June
Issue Type	Secondary Sale/OFS
Pre-Issue Equity Shares Outstanding	9.9 Cr
Post-Issue Equity Shares Outstanding	9.9 Cr
Issue Size	2.47Cr Shares
Price Band	₹380 to ₹421
Market Cap at Upper Band	₹4,168 Cr
EV at Upper Band	₹3,608 Cr
FY16 EBITDA	₹513 Cr
FY16 PAT	₹309 Cr
TTM P/E at Upper Band	13.5x
TTM EV/EBITDA at Upper Band	7.1x

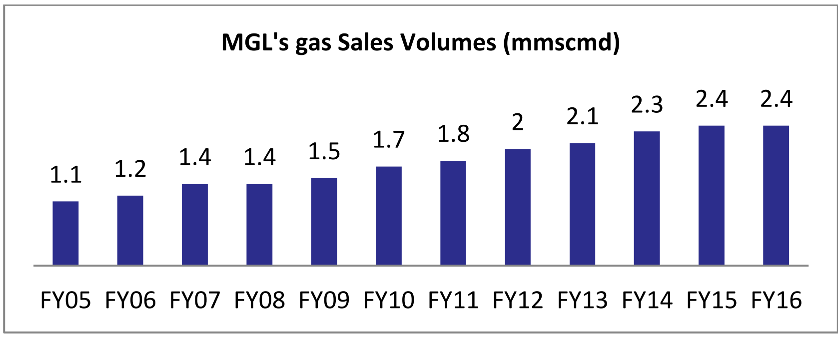
About the Company: MGL is the sole city gas distributor entity in Mumbai, Thane, Navi Mumbai and Raigad. The business is inherently monopolistic in nature and faces negligible threats from competition. We like the business as a result of the following attributes

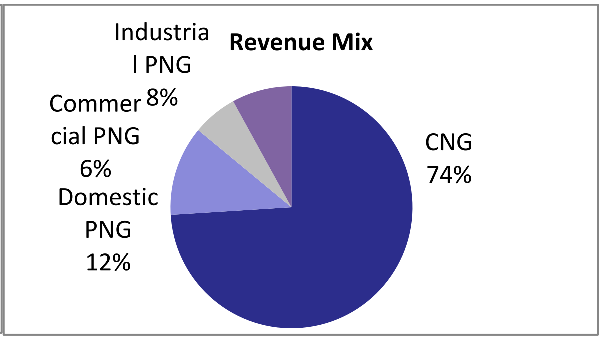
Moat, High Barriers to Entry:

- MGL has not faced any competition even after expiry of marketing exclusivity for its existing areas in January 2012, which shows the high entry-barriers to the business
- Limited land availability and a developed pipeline network
- Price inelastic supplier preference among PNG consumers

Stable Volume Growth & Revenue Mix

- 86% of MGL's volumes are CNG and domestic PNG – a B2C utility business with a stable demand outlook
- Penetration of CNG (25%) and domestic PNG (30%) is low in Mumbai, 25% CNG Vehicles, ~30% PNG
- Thane, Navi Mumbai and Raigad are yet to be fully serviced.
  - MGL has added 60-80,000 domestic PNG connections and plans to double the same.
- PNG & CNG penetration bound to increase due to favourable unit economics for end-users
  - PNG, without government subsidies is the same price as LPG cylinders with subsidy, while CNG cars have a payback period of as low as 10 months, fuel costs are lower by ~50% on a per kilometre basis as compared to petrol
- MGL is working to set up CNG outlets in peripheral highways to fuel inter district and interstate transportation, around major highways near Mumbai such as Nasik, Pune and Goa
- We expect the sales mix for MGL to remain largely stable going forward with Industrial PNG, shrinking slightly going forward, as the B2C in-elastic business grows faster





Source: DRHP

Comparative Analysis:-

Particulars (FY16)	MGL	IGL	Gujarat Gas
CNG Outlets	188	340	248
Compression Capacity (Mn Kg/Day)	3.1	6.9	2.5
CNG Volumes (mmscmd)	1.8	3.1	0.9
CNG Throughput Per Outlet (mmscm)	3.5	3.3	1.3
Domestic PNG Customers (mn)	0.87	0.64	1.06
Commercial & Industrial PNG Lines	2,926	2,580	14,200
Total Pipeline Network	5,061	10,151	17,400
PNG Volumes (mmscmd)	0.6	0.9	4.7
Total Gas Volumes (mmscmd)	2.4	4.0	5.6
Total Gas Volumes (mmscm)	876	1,460	2,044
Total Revenues (₹bn)	20.8	36.9	61.1
Revenue (₹/SCM)	23.8	25.2	29.9
Gross Profit (₹bn)	8.2	13.9	11.4
Gross Profit (₹/SCM)	9.4	9.5	5.6
Gross Margin (%)	*40%*	*38%*	*19%*
EBITDA (₹bn)	5.1	7.7	8.6
EBITDA (₹/SCM)	5.8	5.3	3.4
EBITDA Margin (%)	24%	21%	11.4%
PAT (₹bn)	3.1	4.2	1.5
Market Cap (₹bn) (Upper End - Price Band)	41.6	86.8	71.2
Price/Earnings Ratio	13.4x	20.7x	47.4x
Enterprise Value ₹bn)	36.1	79.6	86.0
EV/EBITDA Ratio	7.1x	10.3x	10.0x
ROAE (%)	21%	18%	7%
ROACE (%)	23%	22%	9%

- Revenue/unit is lower compared to competitors driven by product mix- higher proportion of b2c business
- Business has high operating leverage (Customers pay for installation charges), CNG Pumps have cap-ex, but op-ex stays fixed irrespective of price/volume gains
- Future volume growth to come largely from new tenders opening for piped gas & CNG with
    - This would provide the ability to redeploy earnings at a 20+% ROE
- Given the high density area's where the company operates it enjoys clear operating efficiencies (Higher gas throughput per outlet) as compared to peers

Risk Factors:

- **Regulatory:** - The business might face risks from discontinuation of cheap domestic gas supply or pricing controls from the regulator (PNGRB) or courts could pressure margins, however there has been no precedent of the same
- **Project Delays:** Delay in project execution of infrastructure such as pipelines, CNG outlets, etc. could affect future growth

Valuations & Recommendation:

- MGL should quote at multiples equivalent to or higher than competition given superior return ratios and equivalent growth prospects
- Valuing the business at 10.0x LTM EBITDA in line with listed peers, we arrive at a valuation of ₹575/Share implying a 36.5% upside from the IPO price
- Given the stable cash flows inherent in the business one can expect significantly higher valuations if the management decides to go for a debt recapitalization of the business, however we do not incorporate the same into our valuations

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