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Initiating Coverage

Mahanagar Gas Ltd.

19-November-2020

RETAIL RESEARCH

Mahanagar Gas Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
City Gas distribution	Rs. 905	Buy at LTP & add further on dips to Rs 821- 825 band	Rs. 963	Rs. 1031	2 quarters

HDFC Scrip Code	MAHGAS
BSE Code	539957
NSE Code	MGL
Bloomberg	MAHGL IN
CMP Nov 18, 2020	905.0
Eq- Capital (Rscr)	98.8
Face Value (Re)	10.0
Eq- Share O/S (cr)	9.9
Market Cap (Rscrs)	8939.4
Book Value (Rs)	298.9
Avg.52Wk Volumes	970585
52 Week High	1246.8
52 Week Low	666.4

Share holding Pattern % (Sept, 2020)	
Promoters	32.5
Institutions	55.7
Non Institutions	11.8
Total	100.0

Fundamental Research Analyst
Abdul Karim
abdul.karim@hdfcsec.com

Our Take:

Despite the current weakness due to the Covid-19 pandemic, the long-term outlook for the CGD sector remains favourable for existing cities, where incumbents are already operational with domestic gas allocation in place for CNG and PNG (domestic) segments, which should witness healthy growth in volumes. While growth of CNG could be supported further by conversion of auto-rickshaws and taxis to CNG and its cost advantage over alternative fuels, the PNG (domestic) segment will continue to benefit from the cessation of LPG subsidy for high-income consumers.

BEST (Brihanmumbai Electricity Supply and Transport) had a plan to add around 500 buses out of which it has inducted ~300 CNG buses of and consuming CNG at normal about 1 lakh kgs a day and expects another ~150 CNG buses to be added by the end of Oct 2020 and total number of BEST buses could reach at ~2350. BEST is also likely to add another 800–1,000 CNG buses over and above the current ongoing induction of 500 buses. It could add volume growth of MGL going forward.

MGL is expanding its presence through a pipeline network and plans to add 15 new CNG stations in FY21E. Raigad is expected to peak volumes of 0.6 mmscmd in next 3-5 years. CNG is a big opportunity and we expect MGL to capitalize on this next year by adding new stations and upgrading the existing stations in this region. For PNG growth, MGL has laid pipelines and only capex related to last mile connectivity is pending. Total Capex in FY20 was Rs 415 crore and Company has capex target of anywhere between Rs.500 crore to Rs.600 crore in FY21E and FY22E, but it will be dependent upon the speed at which particularly the permissions are received from various statutory authorities. Around Rs.120 odd crore will be in the area of Raigad, rest in other than Raigad area. MGL added three new CNG stations in Q2, taking their count up to 259. MGL plans to add over 20 new CNG stations and upgrade capacity of over 15 stations in FY22E.

Valuations & Recommendation:

CGD (City Gas Distribution) business is monopolistic in nature due to allotment of license for specified region and cities (Gujarat Gas for Surat, Bharuch & Ankleshwar, Indraprastha Gas Ltd for Delhi, Ghaziabad, Noida & Greater Noida, MGL for Mumbai, Thane, Mira Bhayandar & Navi Mumbai). MGL's current area is inhabited by almost 2 crore people and offers a natural gas potential of about 5 MMSCMD (vs 2.95 MMSCMD in FY20). MGL enjoys a strong financial profile – debt-free balance sheet, strong free cash flow and robust return ratios. Despite operating in an asset-heavy industry, MGL has maintained low debt levels and increased its customer base. It has been consistently paying

dividends. **We feel investors could buy the stock at LTP and add on dips to Rs 821–825 band (~11.5xFY22E EPS). Base case fair value of the stock is Rs 963 (13.5.0xFY22E EPS) and the bull case fair value of the stock is Rs 1031 (14.5xFY22E EPS) over the next 2 quarters. At the CMP of Rs 905 the stock trades at 12.7xFY22E EPS.**

Financial Summary

Particulars (Rs cr)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	FY19	FY20	FY21E	FY22E
Total Operating Income	506.7	783.6	-35.3	261.8	93.6	2,791.1	2,972.1	2,296.4	2,808.1
EBITDA	221.1	273.4	-19.1	80.0	176.4	885.5	1,052.8	833.4	1,037.6
Depreciation	42.5	39.1	8.6	42.3	0.5	125.9	161.7	169.9	179.4
Other Income	18.4	23.0	-19.8	24.5	-24.8	77.7	99.0	91.9	91.3
Interest Cost	2.0	1.5	40.0	1.5	32.7	0.3	6.5	7.3	5.9
Tax	50.7	-14.8	-443.0	15.5	227.7	290.5	190.0	190.4	239.2
APAT	144.3	270.6	-46.7	45.3	219.0	546.4	793.5	557.7	704.4
Diluted EPS (Rs)	14.6	27.4	-46.7	4.6	219.0	55.3	80.3	56.5	71.3
RoE-%						22.8	26.9	16.8	18.5
P/E (x)						16.4	11.3	16.0	12.7
EV/EBITDA						9.8	8.3	10.4	8.2

(Source: Company, HDFC sec)

Q2FY21 Result Review

- MGL reported better than expectations numbers in Q2FY21, consolidated net profit slipped by 46.7% YoY to Rs 144.3 crore and net income from operation was down by 35.3% YoY to Rs 506.7 crore impacted by lower CNG demand due to restrictions in vehicle movement. Demand from industrial and commercial customers were also impacted due to the lockdown. However, volume increased sequentially and Company's volume is coming to pre covid level. CNG segment has recovered to 90-95% of pre-COVID levels in Nov-2020. Domestic and industrial PNG segment has reached over 100% recovery.
- EBITDA stood at Rs 221 crore, down by 19.1% and the margin grew to 43.6% in Q2FY21 against 34.9% posted in Q2FY20.
- CNG sales volume declined 42% YoY and increased 168.7% QoQ to 117.4 SCMM and PNG sales volume was unchanged YoY basis and grew by 27.3% QoQ to 73.3 SCMM in Q2FY21. Overall volume was down by 30.9% YoY and 88.3% QoQ to 88.3 SCMM in Q2FY21. EBITDA/SCM stood at Rs 11.6/SCMM in Q2FY21 vs. Rs 9.9/SCM in Q2FY20 and Rs 7.9/SCM in Q1FY21.

Recent Triggers

Expectation of bidding in 11th round of CGD into new geographies to generate revenue going forward

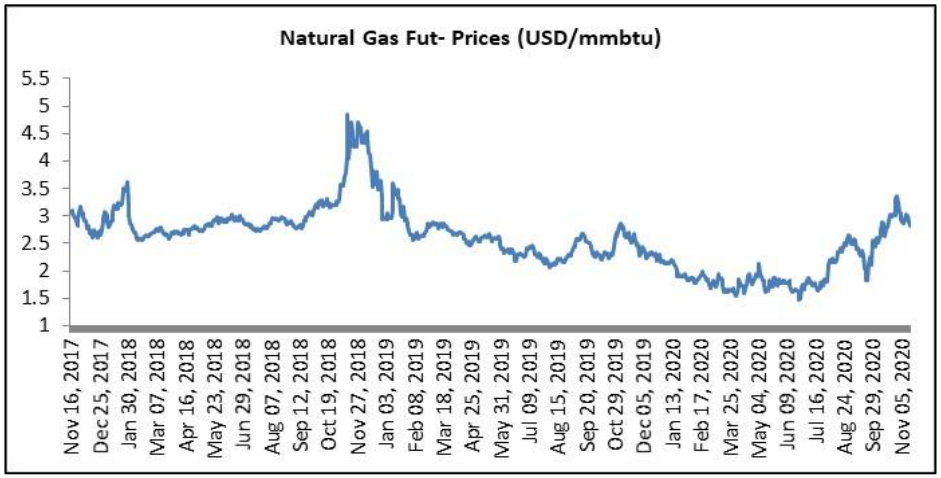
PNGRB is planning to come up with the 11th bidding round for 44 new GAs. The 11th bidding round will further enhance the CGD network in the country. However, on account of the lockdown, the bidding has got delayed. Government of India will soon launch 11th city bid round to give out licenses for retailing gas in cities to help extend the coverage of environment-friendly fuel to about 500 cities. The push for city gas expansion is part of the government plan for raising the share of natural gas in the country's energy basket to 15 per cent by 2030 from the current 6.3 per cent.

Post 9th and 10th bidding round the total number of Geographical areas (GA) has increased from 92 to 228 and the population coverage from 20% to around 71% which would help to increase the customer penetration. With an estimated investment of around Rs.120,000 crore in CGD infrastructure, the newly authorized GAs will become operational in the next 5 years and add to a significant gas volume in the domestic CGD sector. MGL had not won any geographical area (GA) in the 9th and 10th rounds of CGD bidding, although the company is looking forward to the 11th CGD round and might bid for the same once it is open for bidding.

Recent fall in LNG prices & local gas prices, and new natural gas price mechanism allows leeway to maintain / increase margins

The margins of CGD players is expected to improve given the low input cost of domestic gas (55% of consumption at industry level) as well as low LNG prices (imported LNG – 45%). There is expectation of a further decline in gas prices in near to medium term. Given the fact that the selling price of alternative transportation fuel (petrol and diesel) has not witnessed any major downward revision, the economics of price will continue to be in favour of CNG.

Apart from this, Petroleum and Natural Gas Regulatory Board (PNGRB) order for GAIL and National Green Tribunal's strict action on polluting fuels, could result in volume upside and market share gains for CGD players. Meanwhile, the hike in the price of CNG price in Mumbai bodes well for the margins of Mahanagar Gas and MGL relies primarily on spot buying for the PNG (industrial and commercial) categories. In Oct-2020, the government has approved the standardised e-bidding process for natural gas. The oil minister said that producers can choose any platform for e-bidding of natural gas but producing companies cannot participate in natural gas bidding. However, subsidiary or affiliate companies can participate in the process provided they are not the only companies participating in the bidding..



(Source: Investing.com, HDFC sec)

Long term Triggers

Extensive infrastructure and strong promoter (GAIL)

- At present, MGL enjoys a near monopoly status and has a first-mover advantage in retail gas distribution in Greater Mumbai (GA1) and its expansion areas (GA2). The company has, thus, been able to take the regular price hikes to factor in the increase in input costs, thereby protecting its operating margins.
- MGL has put in place large plans to augment its gas distribution network in the existing Mumbai region as well as the surrounding regions. Company currently operates in three GAs—GA1 (the Greater Mumbai region), GA2 (expansion areas such as Mira-Bhayander, Thane-Vashi-Belapur (TVB), Kharghar-Panvel-Taloja (KPT), Kalyan-Dombivli-Ambernath and Ulhasnagar), and GA3 (the Raigad district, won by the company in April 2015).
- MGL is undertaking capex for setting up its network in Raigad, Maharashtra (its third GA). MGL has achieved limited progress on its infrastructure plans in Raigad compared to the minimum work programme (MWP) submitted to the GoI, due to delays in receiving necessary approvals.

- MGL is promoted by GAIL (India) Ltd, having a depth of understanding and interest in the domestic gas distribution business. Recently appointed Chairman of GAIL, Mr. Manoj Jain is currently serving as the chairman of MGL. GAIL has a 32.5% shareholding in MGL.
- A favourable allocation policy assures gas availability from GAIL for CNG and PNG (domestic) segments. In February 2014, the GoI announced allocation of 100% domestic gas towards CNG and PNG (domestic) segments of CGD entities, up from the initial 80% proportional allocation. However, for its PNG (industrial and commercial) segments, where there is growth potential in the expansion areas, MGL's ability to meet additional gas requirements at competitive prices would remain critical.

Company could see more demand in the future

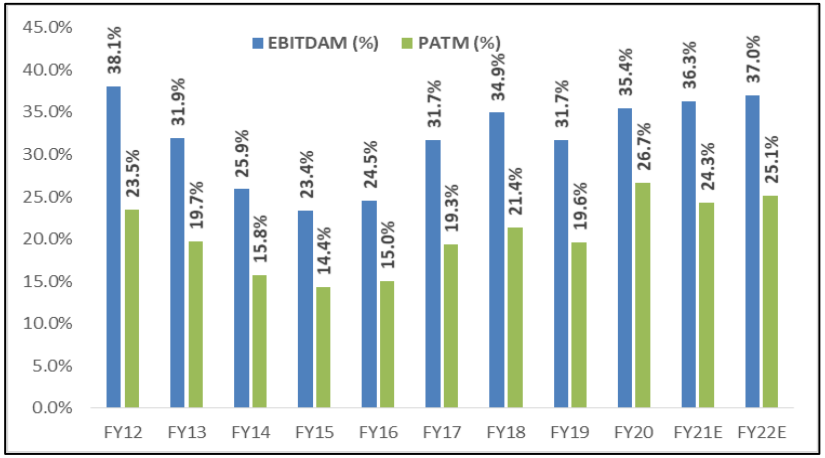
The number of large and medium units in MGL-operated areas is 1,082 as on FY16 (Source: Ministry of MSME), which is similar to that of IGL's 1,266, Adani Gas' 1,274 and GAIL Gas' 1,034. However, MGL gas sales to industry is the lowest among peers at 0.2mmscmd vs IGL's 0.4mmscmd, Adani Gas' 0.7mmscmd and GAIL Gas' 1.5mmscmd. This implies MGL areas are underpenetrated as far as sales to industry is concerned and offer 0.9mmscmd of new gas demand from industries, equivalent to EPS benefit of Rs 10.0 over FY20-25E, due to sustained weak LNG prices and policy push.

Sound fundamentals led by good dividend yield, high OPM, no debt and high return ratios

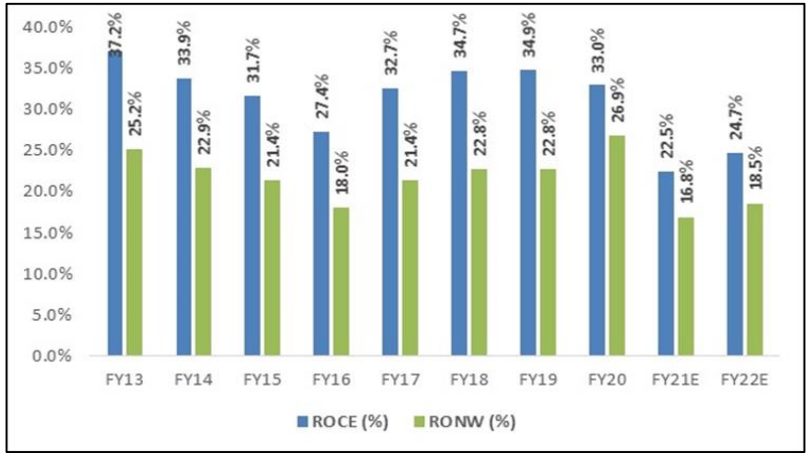
- MGL has maintained its operating and net profit margins throughout the years despite volatility in natural gas prices even when the input and output prices are governed by external factors.
- It's a debt-free company, and a cash-rich one, with free cash flows for the last 7 years. MGL recommended a final dividend of 10.50/- and special dividend of 15/- per equity share (face value of 10/- each) for FY20. Total dividend for FY20 is 35/- per equity. We expect total dividend of Rs 20 per share in FY21E and FY22E each, respectively.
- Its return ratios are high at 33% (ROCE) and 26.9% (RoE) in FY20. We believe that the company is likely to maintain its current EBITDA margins of 36-37%, given increasing penetration and cost benefits for consumers. Its capex will be largely met from the cash reserves, and it may not need to borrow funds for the same.
- Operating performance could gradually improve in the medium term with better absorption of employee costs and moderate revenue growth in the coming quarters.

Mahanagar Gas Ltd.

Margins (%)



Return Ratio (%)



Free Cash Flow (Rs in Crore)

What could go wrong?

- Economic slowdown, volatility in oil and gas prices and regulatory changes could impact its growth story in near future.
- MGL largely depends on the CNG business. For FY14, FY15, FY16, FY17, FY18, FY19 and FY20 the sale of CNG accounted for 61.82%, 65.10%, 71.05%, 70.9%, 69.2%, 69.4% and 69.5% 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.
- MGL's Mumbai exclusivity ends in the year 2020, and competition can come in by the way of new players. However, it is difficult to replicate the company's infrastructure at low costs. No competitor can replace the 5,513 km pipeline network of MGL.
- Government is likely to allow participation more than one player in a circle. No timeline has been given for allowing new competition in various areas. However, we expect, Mumbai and Delhi will be the first two cities where the competition will be allowed, which may have some impact on the growth of MGL. Open access continues to remain the key risk/opportunity for the sector. Any aggressive move by OMCs in CNG space can bring in meaningful risks to both volume & margins for players like MGL.
- The popularity of Electric enabled vehicles has been growing in India with government introducing various incentive schemes. In medium to long term, these cars may pose a potential threat to CNG run vehicles. For meeting the challenge, Company has entered into charging facilities at its stations for electric vehicles.
- The CGD industry is under regulatory regime wherein the Regulatory Board (PNGRB) has framed various regulations, which monitors day to day business operations of the CGD entity. The changes in the regulations, inter-alia, and marketing exclusivity may have an adverse impact on the Company.
- PNGRB has published draft regulations for determining tariff for third-party open access for CGD network and CNG segment, which will be effective for a geographical area post the end of exclusivity period from the purview of common or contract carrier. Any adverse development in this regards could be a risk.
- Risks to profitability of companies like MGL arise from possibility of change in gas allocation or capping of margins/returns, which cannot be foreseen at this point in time.
- Implication of proposed unbundling of GAIL is not known currently.
- Ongoing expansion plans in Raigarh is running behind schedule.
- MGL's old operating areas are largely saturated with negligible CNG growth & as Ola/Uber additions have peaked out, volume growth could slow further. Volume growth has been subdued over the last few years and may not see strong acceleration in the coming 1-2 years and upcoming extension project of Mumbai Metro could impact its volume growth in the future.

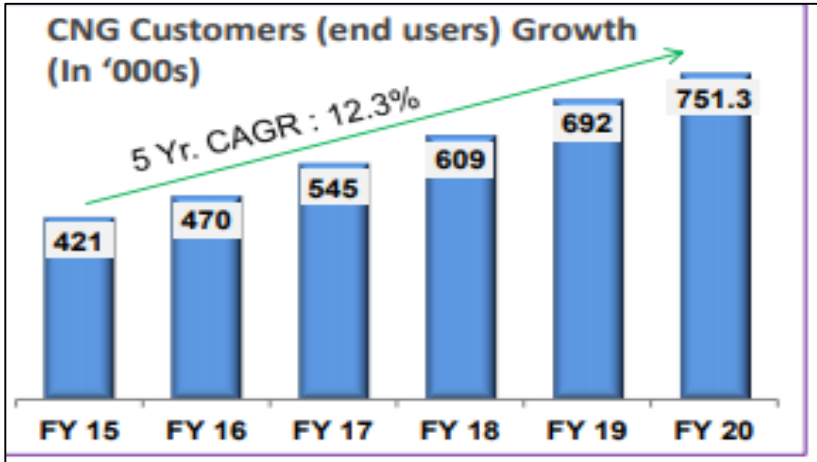
Company Profile:

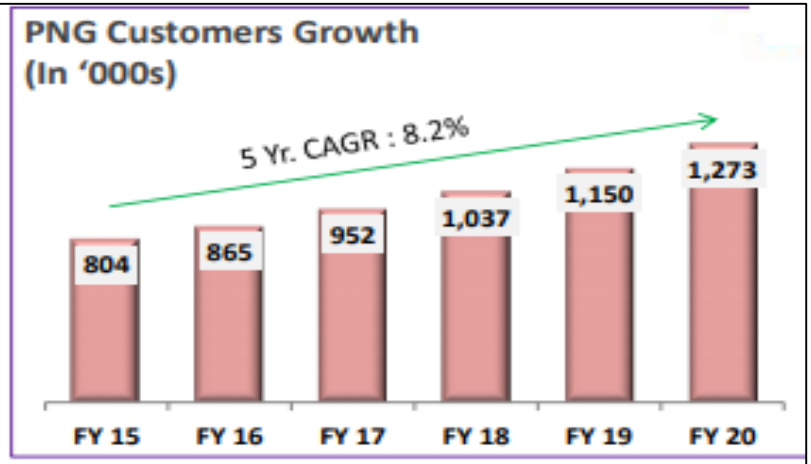
Mahanagar Gas Ltd (MGL) is one the India's leading Natural Gas Distribution Companies. MGL is presently the sole authorised distributor of compressed natural gas (CNG) and piped natural gas (PNG) in Mumbai, its adjoining areas and the Raigarh district in the state of Maharashtra. Over the last 24 years, MGL has established a strong presence in the Greater Mumbai gas distribution business (where it enjoys a monopoly), with its growth being driven primarily by the CNG category, which currently drives 70-75% of its revenues. Company also supplies PNG to industrial, commercial, and residential/domestic segments. It added 28 new industrial/commercial PNG customers, taking the count up to 4,046. 16,223 new domestic households were connected in Q2FY21.

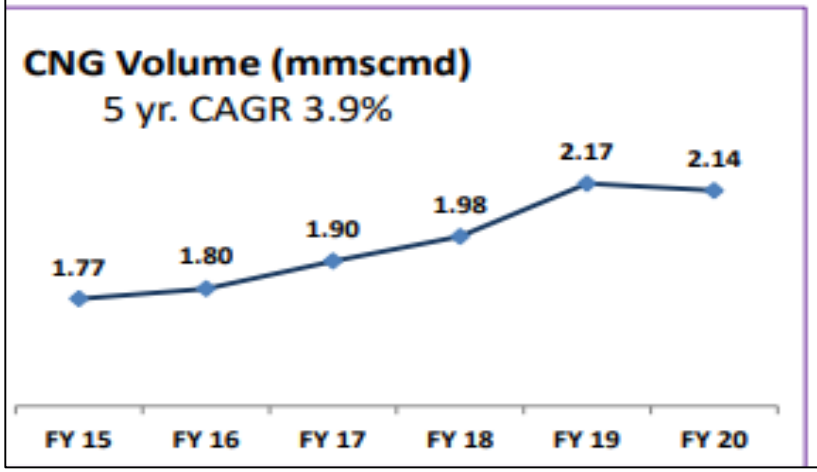
Area of Operations (As at 31st May 2020)

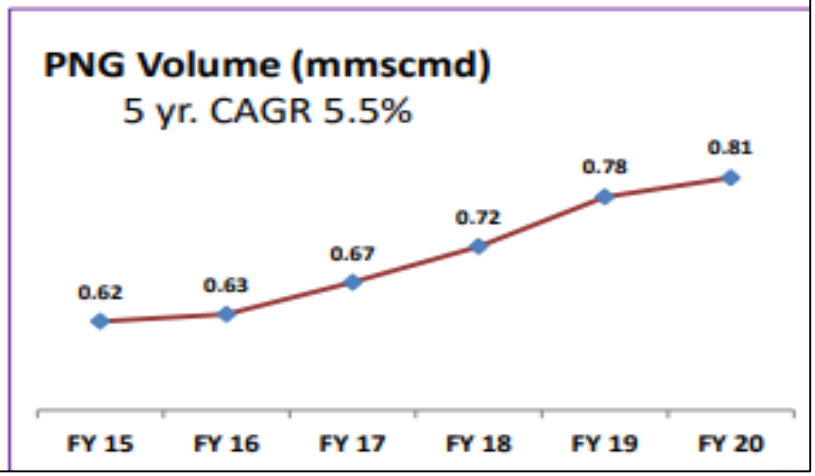
Areas of Operation	Mumbai & Greater Mumbai	Mira-Bhayander, Navi Mumbai, Thane City, Kalyan, Taloja, Ambernath, Dombivli, Ulhasnagar, Badlapur, Bhiwandi, Kharghar and Panvel	Raigad District (adjacent to existing area of operation)
Population (mn)	20.7 mn population and 3.2 mn households [1]		
Infrastructure Exclusivity	2020	2030	2040
MGL Pipeline[2]	5631 kms		
MGL PNG Connections[2]	~ 1.48 mn		
MGL CNG Stations[2]	256		
MGL CNG Customers[2]	~ 0.75 mn		

Operating Metrics









Sales Volume

Particulars	Unit	Q2FY21	Q1FY21	Q4FY20	Q3FY20	Q2FY20	Q1FY20	Q4FY19	Q3FY19	Q2FY19	Q1FY19
CNG	**SCM Mn**	**117.4**	**43.7**	**180.2**	**204.6**	**202.6**	**197.0**	**197.6**	**199.8**	**200.5**	**193.1**
PNG-Domestic	SCM Mn	42.6	39.0	38.2	37.9	35.0	36.4	35.2	35.5	33.5	32.9
PNG-Indust-Commercial	SCM Mn	30.7	18.6	35.1	38.3	38.4	36.7	37.7	37.1	38.3	35.5
PNG Total	**SCM Mn**	**73.3**	**57.6**	**73.2**	**76.2**	**73.4**	**73.1**	**72.9**	**72.7**	**71.8**	**68.3**
Total Volume	**SCM Mn**	**190.7**	**101.3**	**253.4**	**280.8**	**276.0**	**270.1**	**270.5**	**272.5**	**272.3**	**261.4**

Sales Mix (Rs in crore)

Particulars	Q2FY21	Q1FY21	Q4FY20	Q3FY20	Q2FY20	Q1FY20	Q4FY19	Q3FY19	Q2FY19	Q1FY19
CNG	296.3	110.6	463.5	522.6	547.7	517.5	496.1	503.8	466.7	416.2
PNG	206.1	148.8	216.6	216.1	228.9	232.7	219.1	242.3	223.8	197.6
Traded Item	0.9	0.6	1.0	0.7	1.6	2.0	1.5	1.3	1.3	1.1
Total Sales	**503.3**	**260.0**	**681.1**	**739.5**	**778.2**	**752.2**	**716.7**	**747.5**	**691.8**	**614.9**
Other Operating Income	3.4	1.7	5.4	5.0	5.4	5.3	5.9	5.2	4.7	4.5
Total Income from Operation	**506.7**	**261.8**	**686.6**	**744.5**	**783.6**	**757.5**	**722.5**	**752.7**	**696.5**	**619.4**

Peer Comparison

(On TTM basis)

Name	CMP Rs.	Mar Cap Rs.Cr.	EPS 12M Rs.	OPM %	NPM %	Div Yld %	ROE %	Debt / Eq	P/BV	P/E
Indraprastha Gas	449.7	31464.8	14.3	24.4	19.5	0.6	24.5	0.0	5.6	31.4
Adani Gas	345.1	37876.7	3.7	39.0	26.7	0.1	33.5	0.3	23.1	90.7
Guj.St.Petronet	191.5	10801.8	25.2	29.8	17.5	1.0	55.7	0.4	2.0	5.8
Mahanagar Gas	**905.1**	**8941.9**	**54.9**	**36.5**	**24.7**	**2.2**	**29.7**	**0.0**	**3.1**	**16.5**
Gujarat Gas	324.8	22355.5	14.3	19.6	11.2	0.4	43.5	0.4	5.9	22.8

Financials

Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Net Revenues	2233.0	2791.1	2972.1	2296.4	2808.1
Growth (%)	9.8	25.0	6.5	-22.7	22.3
Operating Expenses	1452.9	1905.6	1919.3	1463.0	1770.5
EBITDA	780.1	885.5	1052.8	833.4	1037.6
Growth (%)	21.1	13.5	18.9	-20.8	24.5
EBITDA Margin (%)	34.9	31.7	35.4	36.3	37.0
Depreciation	111.2	125.9	161.7	169.9	179.4
EBIT	668.9	759.5	891.1	663.5	858.2
Other Income	57.7	77.7	99.0	91.9	91.3
Interest expenses	0.1	0.3	6.5	7.3	5.9
PBT	726.5	836.9	983.5	748.1	943.6
Tax	248.6	290.5	190.0	190.4	239.2
RPAT	477.9	546.4	793.5	557.7	704.4
Growth (%)	21.5	14.3	45.2	-29.7	26.3
EPS	48.4	55.3	80.3	56.5	71.3

Balance Sheet

As at March	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share Capital	98.8	98.8	98.8	98.8	98.8
Reserves	1996.6	2300.1	2853.9	3214.0	3701.2
Shareholders' Funds	**2095.4**	**2398.9**	**2952.7**	**3312.8**	**3799.9**
Long Term Debt	1.2	0.0	49.0	44.0	39.0
Net Deferred Taxes	174.8	204.8	160.7	136.6	122.9
Long Term Provisions & Others	15.6	16.1	19.0	19.8	20.7
Minority Interest	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total Source of Funds	**2287.0**	**2619.8**	**3181.3**	**3513.2**	**3982.6**
APPLICATION OF FUNDS					
Net Block & Goodwill	1888.6	2133.1	2535.7	2665.8	2786.4
Other Non-Current Assets	146.2	132.1	87.1	94.2	105.8
Total Non Current Assets	**2034.7**	**2265.2**	**2622.8**	**2760.0**	**2892.2**
Current Investments	0.0	0.0	0.0	0.0	0.0
Inventories	24.0	19.1	18.6	12.6	15.4
Trade Receivables	91.4	99.5	68.4	62.9	100.0
Cash & Equivalents	779.6	952.9	1351.0	1473.0	1698.4
Other Current Assets	80.6	104.4	67.7	74.5	83.4
Total Current Assets	**975.5**	**1175.9**	**1505.7**	**1623.0**	**1897.2**
Short-Term Borrowings	0.0	0.0	0.0	0.0	0.0
Trade Payables	110.0	152.4	131.8	94.4	107.7
Other Current Liab & Provisions	613.2	668.8	815.4	775.5	699.2
Total Current Liabilities	**723.3**	**821.2**	**947.2**	**869.8**	**806.9**
Net Current Assets	252.2	354.7	558.5	753.2	1090.4
Total Application of Funds	**2287.0**	**2619.8**	**3181.3**	**3513.2**	**3982.6**

Mahanagar Gas Ltd.

Cash Flow Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Reported PBT	726.5	836.9	983.5	748.1	943.6
Non-operating & EO items	-39.5	-44.3	-68.5	-81.9	-91.3
Interest Expenses	0.1	0.3	6.5	7.3	5.9
Depreciation	111.2	125.9	161.7	169.9	179.4
Working Capital Change	82.2	36.6	137.4	102.8	-135.6
Tax Paid	-228.4	-270.8	-238.0	-190.4	-239.2
OPERATING CASH FLOW (a)	**652.1**	**684.6**	**982.6**	**755.8**	**662.8**
Capex	-268.9	-362.5	-423.2	-299.9	-299.9
Free Cash Flow	383.3	322.2	559.4	455.9	362.9
Investments	1,047.1	47.4	-431.6	-56.1	-58.9
Non-operating income	58.8	-123.5	102.6	91.9	91.3
INVESTING CASH FLOW (b)	**837.1**	**-438.6**	**-752.2**	**-264.1**	**-267.5**
Debt Issuance / (Repaid)	-1.5	-1.2	-15.8	-5.0	-5.0
Interest Expenses	-0.7	-0.3	-7.4	-6.5	-7.3
FCFE	381.0	320.6	536.2	444.4	350.7
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-223.6	-233.0	-218.3	-197.6	-217.3
FINANCING CASH FLOW (c)	**-225.8**	**-234.6**	**-241.6**	**-209.1**	**-229.6**
NET CASH FLOW (a+b+c)	**1,263.4**	**11.5**	**-11.2**	**282.6**	**165.8**

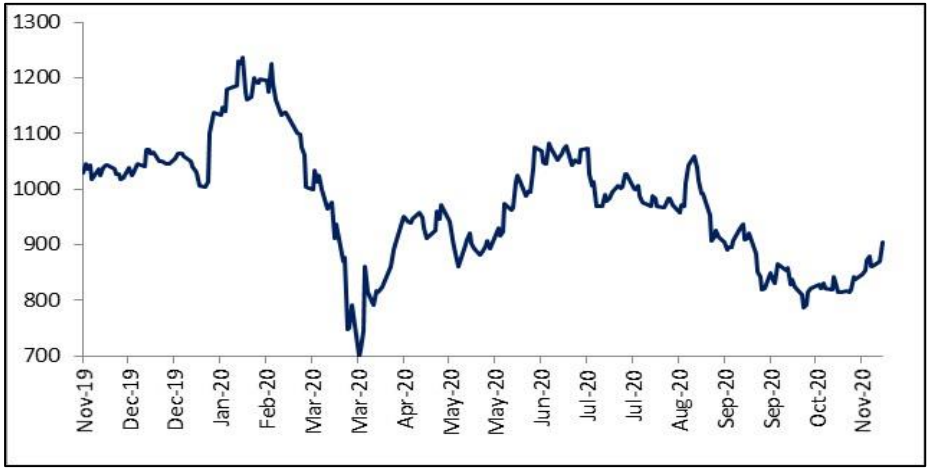
Key Ratios

Particulars	FY18	FY19	FY20	FY21E	FY22E
EBITDA Margin (%)	34.9	31.7	35.4	36.3	37.0
EBIT Margin (%)	30.0	27.2	30.0	28.9	30.6
APAT Margin (%)	21.4	19.6	26.7	24.3	25.1
RoE (%)	22.8	22.8	26.9	16.8	18.5
RoCE (%)	55.2	57.9	60.0	40.1	44.4
Solvency Ratio (x)					
Net Debt/EBITDA	0.0	0.0	0.0	0.1	0.0
Net D/E	0.0	0.0	0.0	0.0	0.0
PER SHARE DATA (Rs)					
EPS	48.4	55.3	80.3	56.5	71.3
CEPS	59.6	68.1	96.7	73.7	89.5
BV	212.1	242.9	298.9	335.4	384.7
Dividend	19.0	20.0	35.0	20.0	22.0
Turnover Ratios (days)					
Debtor days	14.9	13.0	8.4	10.0	13.0
Inventory days	3.9	2.5	2.3	2.0	2.0
Creditors days	18.0	19.9	16.2	15.0	14.0
VALUATION (x)					
P/E	18.7	16.4	11.3	16.0	12.7
P/BV	4.3	3.7	3.0	2.7	2.4
EV/EBITDA	11.3	9.8	8.3	10.4	8.2
EV / Revenues	4.0	3.1	2.9	3.8	3.0
Dividend Yield (%)	2.1	2.2	3.9	2.2	2.4

(Source: Company, HDFC sec)

Mahanagar Gas Ltd.

One Year Stock Price Chart



(Source: Company, HDFC sec)

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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