Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	+	↓	=
RQ	+	↔	+
RV	+	↔	+

ESG Disclosure Score NEW

ESG RISK RATING 34.43

Updated July 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

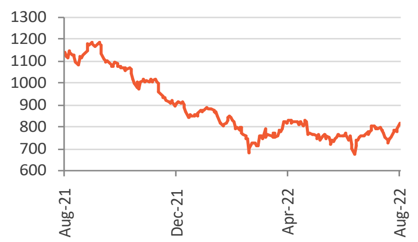
Company details

Market cap:	Rs. 8,072 cr
52-week high/low:	Rs. 1,205/666
NSE volume: (No of shares)	5.4 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	25.8
DII	16.1
Others	25.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.8	7.3	2.2	-28.5
Relative to Sensex	-6.2	-0.7	1.6	-36.7

Sharekhan Research, Bloomberg

Mahanagar Gas Ltd

Robust Q1; maintain Buy on attractive valuation

Oil & Gas	Sharekhan code: MGL
Reco/View: Buy ↔	CMP: **Rs. 817**
	Price Target: **Rs. 930** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q1FY23 PAT of Rs. 185 crore (up 40.5% q-o-q) was above our estimates led by sharp beat in EBITDA margin, higher-than-expected volumes and lower depreciation costs.
- Beat of 9% in EBITDA margin at Rs. 9.1/scm (up 20.5% q-o-q) was led by higher CNG/D-PNG prices and better margins in industrial/ commercial (I&C) PNG as prices were at a premium to alternative fuels. CNG/I&C PNG volumes grew by 11.5%/5% q-o-q to 2.5 mmscmd/0.4 mmscmd while D-PNG volume declined by 1% q-o-q to 0.5 mmscmd.
- New gas allocation policy implemented with uniform base price (UBP at $10.5/mmBtu currently). Management focused to balance between volumes/margin given narrowing of price gap between CNG and petrol and expectations of further gas price hike from October 2022. CGDs in discussion with government for a favourable gas pricing and allocation of HP-HT gas to CGDs.
- We maintain a Buy rating on MGL with an unchanged PT of Rs. 930, noting its inexpensive valuation of 10.5x its FY2024E EPS (at a discount of 30% to three-year average PE of 15x).

Mahanagar Gas Limited (MGL) reported strong Q1FY23 results with a 13%/16% beat in operating profit/PAT of Rs. 286 crore/Rs. 185 crore, up 32.5%/40.5% q-o-q led by beat in both volume/margin and lower depreciation. Volume of 3.4 mmscmd was 4% above our estimate, reflecting strong growth of 11.5%/4.9% q-o-q in CNG/I/C PNG volume at 2.5 mmscmd/0.4 mmscmd while domestic PNG stood at 0.5 mmscmd (down 0.9% q-o-q). EBITDA margin of Rs. 9.1/scm (up 20.5% q-o-q) was above our Rs. 8.3/scm led by improvement in gross margin by 8% q-o-q to Rs. 14.4/scm and lower per unit opex (down 8% q-o-q). The gross margin rise was supported CNG/D-PNG price hike (now at Rs. 86/kg and Rs. 52.5/scm) and better margin in industrial/commercial (I/C) PNG given premium over alternative fuels.

Key positives

- Beat in gross/EBITDA margin at Rs. 14.4/Rs. 9.1 per scm, up 8%/20% q-o-q.
- Better-than-expected volume growth of 9% q-o-q to 3.4 mmscmd with CNG/I-C volume growth of 11.5%/4.9% q-o-q.

Key negatives

- Muted D-PNG sales volume at 0.5 mmscmd; down 0.9% q-o-q.

Management Commentary

- New APM gas allocation policy become effective from May 16, 2022 and gas is allocated at UBP – May/June/July/August price at $8.04/$8.05/$9.05/$10.55 per mmBtu). Spot LNG mix in UBP estimated at 15-20%.
- CGD players are in discussions with the government and oil & gas ministry and they are working on a favourable gas pricing and allocation for CGDs. Government also looking at some allocation of HP-HT gas production to the APM gas pool.
- Price gap between CNG and petrol has narrowed down to 30% but management expects that same would increase with normalisation of gas prices.
- FY23 capex guidance of Rs. 700-800 crore and have done Rs. 150 crore in Q1FY23. MGL's targets to add 25 new CNG station along with upgradation of 25 CNG station and 3 lakh new domestic household customers in FY2023.
- Industrial/commercial PNG prices were hiked sharply to Rs. 65/Rs. 80 per scm versus Rs. 47/ Rs. 56 per scm in Q4FY22.

Revision in estimates – We maintain our FY2023-FY2024 earnings estimate.

Our Call

Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 930: Sustained volume growth and a gradual margin recovery remain key to earnings growth going forward and improvement in investor sentiments for CGDs. We maintain a Buy rating on MGL with an unchanged PT of Rs. 930 given attractive valuations of 10.5x its FY2024E EPS, which are at steep discount of 30% to its three-year average one-year forward PE of 15x.

Key Risks

Lower-than-expected gas sales volume in case of economic slowdown. Delay in development of new GAs, an elevated spot LNG price, and adverse regulatory changes could affect outlook and valuations.

Valuation Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,153	3,560	3,927	4,203
OPM (%)	43.4	26.0	27.0	27.1
Adjusted PAT	620	597	715	768
% YoY growth	-15.9	-3.7	19.7	7.4
Adjusted EPS (Rs.)	62.7	60.4	72.4	77.7
P/E (x)	13.0	13.5	11.3	10.5
P/B (x)	2.5	2.2	2.0	1.8
EV/EBITDA (x)	8.1	8.2	6.6	5.8
RoNW (%)	20.0	17.5	18.9	18.4
RoCE (%)	25.4	22.1	23.5	23.0

Source: Company; Sharekhan estimates

Strong Q1; earnings above estimate led by volume/margin beat

Operating profit of Rs. 285 crore (down 6.1% y-o-y; up 32.5% q-o-q) was 13% above our estimate of Rs. 252 crore primarily due to higher-than-expected EBITDA margin of Rs. 9.1/scm (up 20.5% q-o-q and 9% above our estimate of Rs. 8.3/scm) and volumes of 3.4 mmscmd (up 8.8% q-o-q and 4% above our estimate). Gas sales volumes was strong with 12%/5% q-o-q increase in CNG/I&C volume to 2.5 mmscmd/0.4 mmscmd while domestic PNG volume declined slightly by 0.9% q-o-q to 0.5 mmscmd. PAT, at Rs. 185 crore, (down 9.3% y-o-y; up 40.5% q-o-q) was 16% above our estimate of Rs. 159 crore led by volume/margin beat and lower depreciation.

Q1FY2023 conference call highlights

- **New gas allocation guidelines –** Revised guidelines for allocation of APM gas become effective from 16 May 2022 and gas is provided to all CGD entities at uniform base price (UBP) for 100% requirement of CNG and D-PNG. New APM allocation is revised on a quarterly basis + 2.5%. The UBP is determined and notified every month with May/June price of $8.04/$8.05 per mmBtu.
- **Capex/CGD infrastructure –** Management has guided for capex of Rs. 700-800 crore for FY2023 versus capex spending of Rs. 600 crore in FY2022. Domestic PNG customers stood at 1.93 million (addition of 62,075 households q-o-q), steel pipeline of 6,285 km (addition of 65 km q-o-q), 292 CNG stations (added 2 new CNG station in Q1FY2023), and I/C customers at 4,366 as of June 30, 2022. The Raigad GA has 23 operational CNG stations.
- **CNG conversion and price gap with petrol –** Total CNG conversions stood at over 19,000 in Q1FY2023. MGL added 2700 CVs and created special CNG station for CVs. The price gap between CNG and petrol has reduced to 30% due to sharp CNG price hike and non-revision of petrol price. On running costs, the total saving for CNG cars is at 30% versus petrol cars.
- **MRUs –** MGL has issued an LOI to three MRUs and the parties are in the process of setting up facilities. However, it would take another 5-6 months to see volumes emerge from these facilities.
- **OMCs commission –** The issue with OMCs on trade commissions has been largely settled except for certain areas where OMCs has asked for higher commission.

Results Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	1,455	615	136.4	1,087	33.9
Total Expenditure	1,169	312	275.3	871	34.2
Operating profit	**286**	**304**	**-6.1**	**215**	**32.5**
Other Income	20	19	7.5	23	-11.9
Interest	2	2	34.7	2	0.9
Depreciation	54	45	18.6	56	-3.3
Reported PBT	250	276	-9.5	180	38.4
Tax	64	72	-10.0	49	32.5
Reported PAT	185	204	-9.3	132	40.5
Equity Cap (cr)	10	10		10	
Reported EPS (Rs.)	18.7	20.7	-9.3	13.3	40.5
Margins (%)			**bps**		**bps**
OPM	19.6	49.4	-2976.1	19.8	-19.8
NPM	12.7	33.2	-2042.7	12.1	60.3
Tax rate	25.8	26.0	-16.3	26.9	-113.8

Source: Company, Sharekhan Research

Key operating performance

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Volume (mmscmd)	3.4	2.4	43.8	3.2	8.8
Gross margin (Rs. /scm)	14.4	19.4	-26.1	13.3	8.0
EBITDA margin (Rs. /scm)	9.1	13.9	-34.7	7.6	20.5
CNG volume (mmscmd)	2.5	1.6	63.8	2.3	12
Domestic PNG volume (mmscmd)	0.5	0.5	0.4	0.5	-0.9
I/C PNG volume (mmscmd)	0.4	0.4	15.5	0.4	4.9

Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Regulatory push to drive gas demand in India; High gas price an overhang for CGDs**

Long-term gas demand potential for India is very strong, given regulatory support to curb pollution and low domestic gas prices. Additionally, the government's aim to increase the share of gas in India's overall energy mix to 15% by 2030 (from 6% currently) would substantially improve gas penetration and consumption in the country. Thus, we expect sustainable high single-digit growth in India gas demand in the next 4-5 years. However, elevated spot LNG price and expectation of further steep hike in APM gas prices from October 2022 (post 110% hike to $6.1/mmBtu for H1FY2023) would act as a margin concern for CGDs.

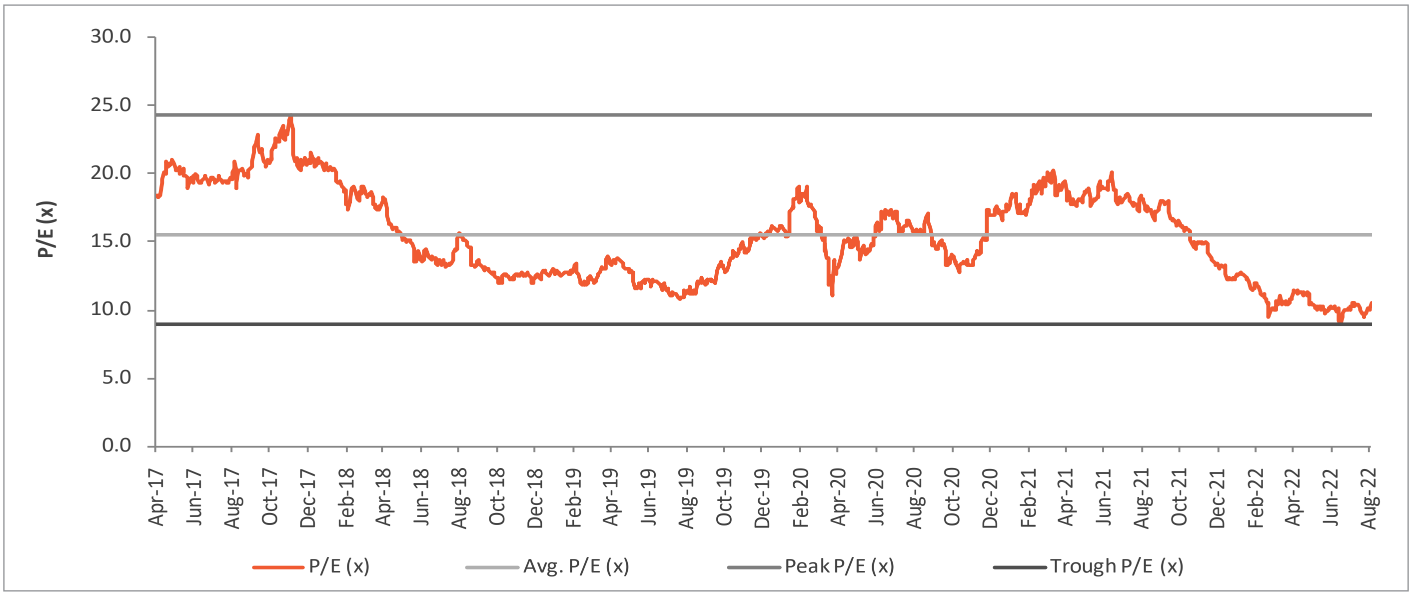
■ **Company outlook - Volume and margin recovery to drive decent earnings growth**

Setting-up of new CNG station in existing Mumbai GA and ramp-up at Raigad GA would drive a 7% volume CAGR over FY2022-FY2024E. We expect EBITDA margins to gradually increase to Rs. 8.1/scm over FY2022E-FY2024E versus 7.4/scm in FY2022, supported by price hikes and potential normalisation of gas price or favourable government decision on domestic gas price given CNG/D-PNG are priority sectors. Hence, we expect a 13% PAT CAGR over FY2022-FY2024E on low base of FY2022.

■ **Valuation - Maintain Buy on MGL with an unchanged PT of Rs. 930**

Sustained volume growth and a gradual margin recovery remain key to earnings growth going forward and improvement in investor sentiments for CGDs. We maintain a Buy rating on MGL with an unchanged PT of Rs. 930 given attractive valuations of 10.5x its FY2024E EPS, which are at steep discount of 30% to its three-year average one-year forward PE of 15x.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

MGL is a dominant CGD player in and around Mumbai with CNG/PNG sales volumes of 3.2 mmscmd currently. MGL derives 72% of its volumes from CNG, 15% from domestic PNG, and the remaining from commercial/ industrial PNG. The company sources its entire gas requirement for CNG and domestic PNG from low-cost domestic gas. The company has 278 CNG stations, 1.79 million PNG customers, and a pipeline network of 6,096 km.

Investment theme

MGL's long-term volume growth outlook is strong supported by the government's aim to increase the share of gas in India's energy mix to ~15% by 2030 (from 6% currently) and the thrust to reduce air pollution provides a regulatory push for strong growth in CNG and domestic PNG volumes for MGL. Development of Raigad GA (0.5 mmscmd volume potential) would further add to the company's volume growth prospects. However, lower APM gas allocation, elevated spot LNG price, and demand for higher dealer commission by OMCs would remain near overhang on margins. MGL is the cheapest CGD stock.

Key Risks

- Lower-than-expected gas sales volume in case of delay in volume recovery due to COVID-19 led demand slowdown.
- Any change in domestic gas allocation policy, depreciation of Indian rupee, and any adverse regulatory changes could affect margins and valuations.

Additional Data

Key management personnel

Manoj Jain	Chairman
Sanjib Datta	Managing Director
Deepak Sawant	Deputy Managing Director
Sunil M Ranade	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	State of Maharashtra	10.00
2	Life Insurance Corp of India	8.32
3	Vontobel Holding AG	5.09
4	FMR LLC	4.61
5	Schroders PLC	2.05
6	Vanguard Group Inc.	1.86
7	Government PENSI	1.62
8	ASI Emerging Markets Fund	1.42
9	HDFC Life Insurance Co Ltd.	1.37
10	ABRDN plc	1.33

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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