Stock Update

Company Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Mahanagar Gas Ltd

Supportive policy framework; attractively valued

Oil & Gas	Sharekhan code: MGL

Reco/View: Buy	↔	CMP: Rs. 855	Price Target: Rs. 980	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Jul 08, 2022

High Risk

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

Source: Morningstar

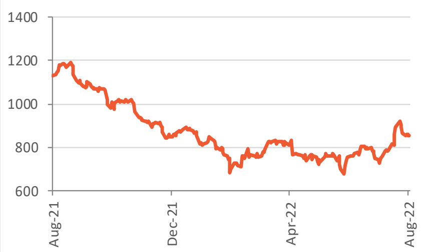
Company details

Market cap:	Rs. 8,443 cr
52-week high/low:	Rs. 1,205 / 666
NSE volume: (No of shares)	5.9 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	14.2	16.5	21.7	-24.5
Relative to Sensex	8.8	9.3	16.4	-29.3

Sharekhan Research, Bloomberg

Summary

- Higher APM gas allocation of 94% to CNG/D-PNG would reduce gas cost by 25% to $8.4/mmBtu for MGL and use of term LNG for remaining 6% gas requirement instead of expensive spot LNG provides room for margin improvement in Q2FY23.
- A potential capping of domestic gas price at current levels and likely change in domestic gas pricing formula would remove margin overhang and drive re-rating for CGDs.
- MGL has cut its CNG price by Rs. 6/kg in Mumbai and this has improved economics of CNG vs petrol. This coupled with ramp-up at Raigad GA (0.5 mmscmd volume potential) would drive 7% volume CAGR over FY22-24E. We highlight here that MGL's Q1FY23 CNG volume grew 14% versus pre-pandemic volume seen in Q3FY20.
- We raise our PE multiple and increase our PT to Rs. 980 while maintaining our Buy rating on MGL. MGL is the cheapest CGD stock and trades at an attractive valuation of 11x FY24 EPS (at 27% discount to 3-year average PE multiple).

Recent government decision to increase gas allocation for CNG and domestic PNG gives indication of favourable policy framework for CGDs as the space would be key to achieve government's target of 15% share of natural gas in India's energy mix by 2030 versus only 6% currently. Higher domestic gas allocation of 94% to CGDs is a near-term relief and raises hope of more measures like capping of domestic gas price at current level. Continued policy support for CGDs would help sustain high volume growth and sustain/improve current margin for MGL. We thus maintain our Buy rating on MGL with a revised PT of Rs. 980 given attractive valuation of 11x FY24E EPS, which is at steep 27% discount to three-year average PE multiple.

- **Healthy volume growth outlook:** MGL's long-term volume growth outlook remains intact led by favourable government policies, which would help keep economics of CNG cars favourable versus petrol cars. We highlight here that MGL has recently cut CNG price by Rs.6/kg and with this CNG cars are now 44% cheaper in terms of running cost than petrol cars versus to 30% till mid-August 2022. Decent growth in existing Mumbai GA and and ramp-up of Raigad CGD GA (0.5 mmscmd volume potential) would drive 7% volume CAGR over FY22-24E for MGL.
- **Lower gas cost – bodes well for Q2FY23 margin:** The government has recently increased domestic gas supply for CNG and domestic PNG to 94% of their total requirement as compared to 85% in Q1FY23. The above measure is expected to reduce gas cost for CGDs (for priority sector CNG and D-PNG) to $8.4/mmBtu from $10.5/mmBtu in August 2022. MGL has entered into term LNG contracts and use of the same for shortfall in domestic gas could further reduce gas cost for MGL. Lower gas cost is expected to support EBITDA margin for MGL (improved q-o-q by 20% to Rs. 9.1 per scm in Q1FY23) given exposure to CNG/D-PNG. We expect more accommodative policy measures by the government like revision in domestic gas pricing formula given high volatility in international gas price (especially NBP) and capping of domestic gas price, which would remove margin overhang for CGDs.
- **PAT to see decent 13% CAGR over FY22-24E post de-growth in FY21/FY23:** We expect MGL's EBITDA margin to gradually increase to Rs. 8.9/Rs. 9per scm in FY2023E/FY2024E versus Rs8.4 /scm in FY2022 supported by proactive pricing and potential normalization of gas price or favourable government decision on domestic gas price given CNG/D-PNG are priority sectors. Volume to witness decent growth of 8%/7% in FY23E/FY24E and reach 3.5 mmscmd. Ramp-up at MRU (issued LOI for 3 MRUs) could further support volume growth. Hence, we expect a 13% PAT CAGR over FY2022-FY2024E along with healthy RoE/RoCE of 18%/23%.

Our Call

Valuation – Maintain Buy on MGL with a revised PT of Rs. 980: Accommodative government policies and likely capping of domestic gas price would improve volume growth visibility (supported by widening of pricing gap between CNG versus petrol) and sustained margin recovery for MGL. We thus increase our PT for MGL to Rs. 980, as we increase our PE multiple given improving policy while maintaining our Buy rating. MGL is the cheapest CGD stock with attractive valuation of 11x FY24E EPS, which is at 27% discount to its 3-year average PE multiple.

Key Risks

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

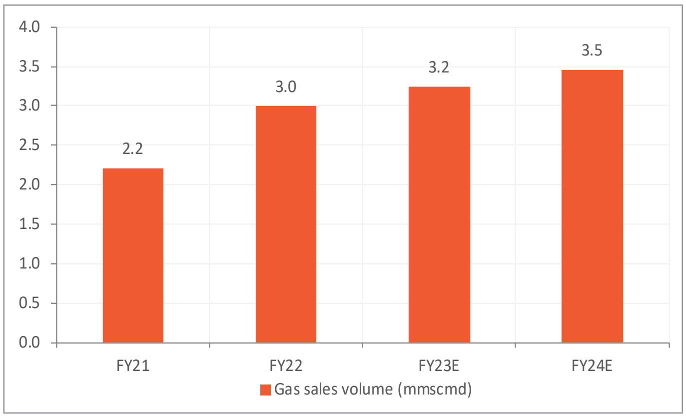
Valuation Rs cr

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)	13.6	14.1	11.8	11.0
P/B (x)	2.6	2.3	2.1	1.9
EV/EBITDA (x)	8.5	8.6	7.0	6.1
RoNW (%)	20.0	17.5	18.9	18.4
RoCE (%)	25.4	22.1	23.5	23.0

Source: Company; Sharekhan estimates

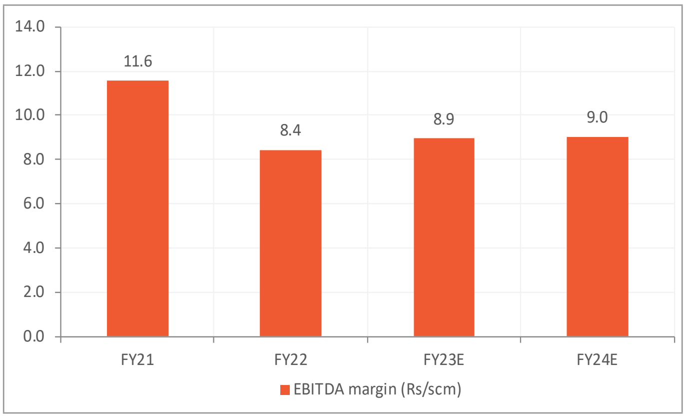
Financials in charts

Volume to post 7% CAGR over FY22-24E



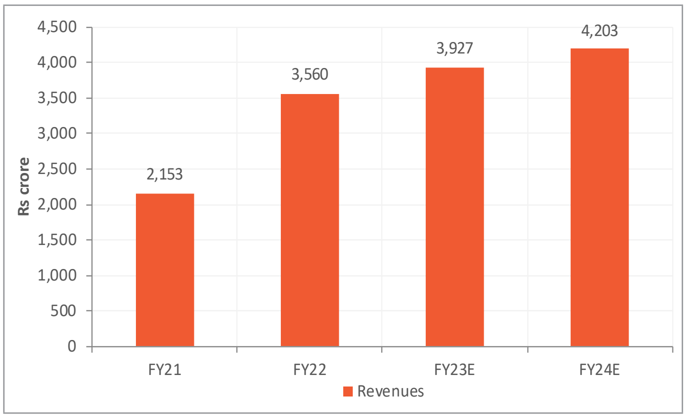
Source: Company, Sharekhan Research

Gradual margin recovery expected over FY23-24



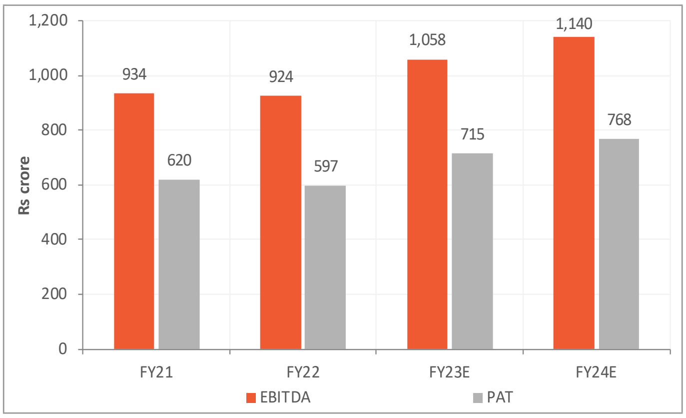
Source: Company, Sharekhan Research

Revenue trend



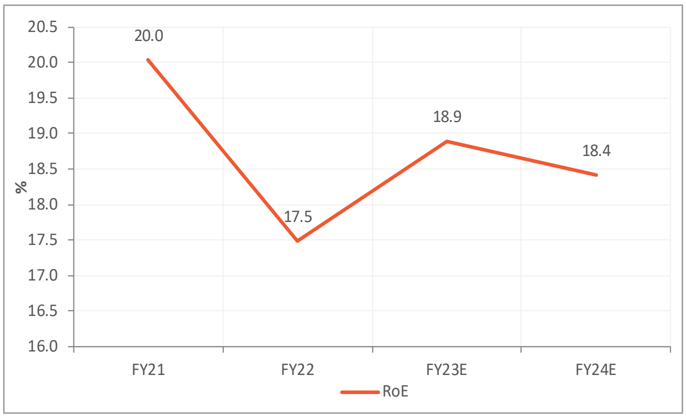
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 11%/13% over FY22-FY24E



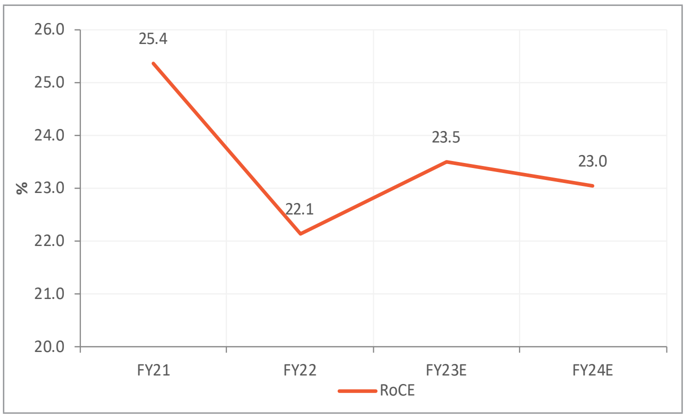
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector View – Regulatory push to drive gas demand; supportive government policies could remove high gas cost overhang for CGDs**

India's long-term gas demand potential 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 boost its consumption. Thus, we expect sustainable high single-digit growth in India gas demand for the next 4-5 years. However, high spot LNG prices, expectation of a further steep hike in APM gas price from October 2022 and indication of faster adoption of EVs is a cause of concern for CGDs. We highlight here that a potential capping of domestic gas price at current level could remove overhang of high cost and margin.

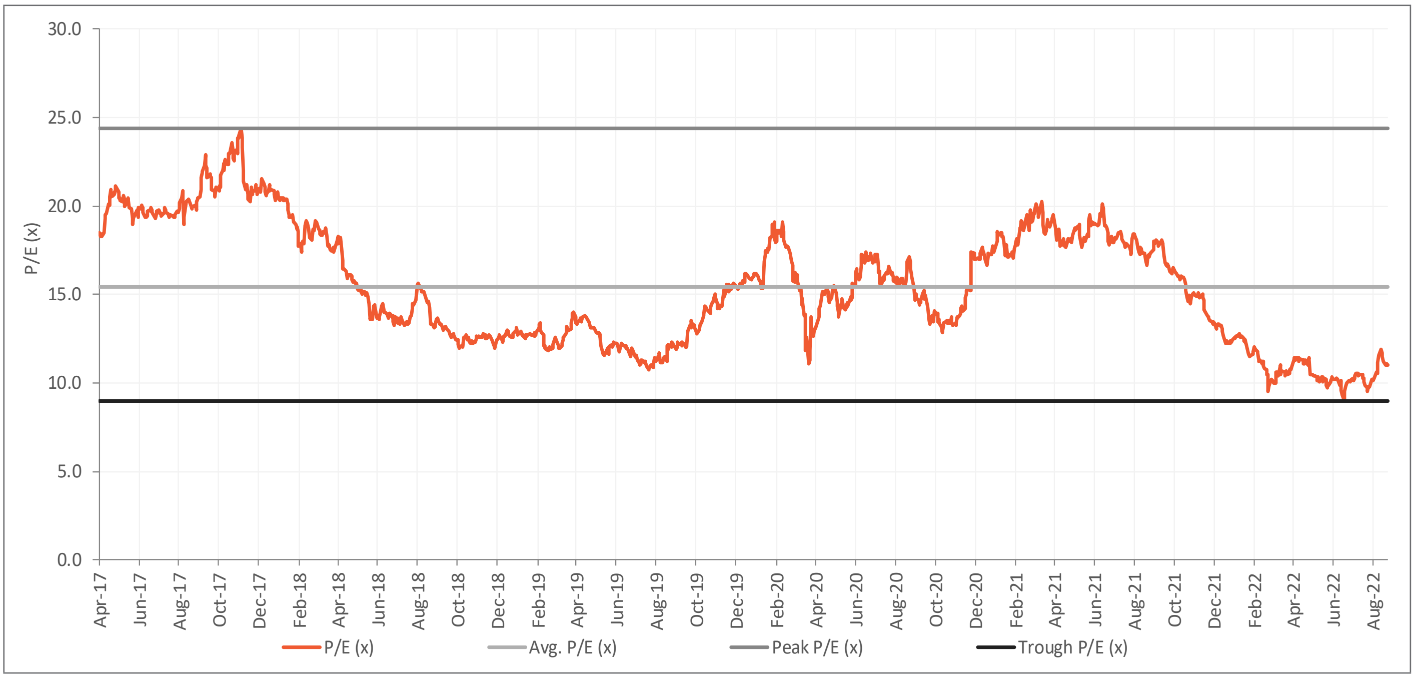
■ **Company Outlook – Volume and margin recovery to drive decent earnings growth**

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 margin to gradually increase to Rs. 8.9/Rs9 per scm in FY2023E/FY2024E versus Rs. 8.4/scm in FY2022 supported by price hike 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 a revised PT of Rs. 980**

Accommodative government policies and likely capping of domestic gas price would improve volume growth visibility (supported by widening of pricing gap between CNG versus petrol) and sustained margin recovery for MGL. We thus increase our PT for MGL to Rs. 980, as we increase our PE multiple given improving policy while maintaining our Buy rating. MGL is the cheapest CGD stock with attractive valuation of 11x FY24E EPS, which is at 27% discount to its 3-year average PE multiple.

One-year forward P/E (x) band



Source: Company, 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 slowdown, lower CNG conversions and delay in development of new Gas
- Any change in domestic gas allocation/pricing policy, depreciation of Indian rupee, higher spot LNG price and any adverse regulatory changes could affect margins and valuations

Additional Data

Key management personnel

Manoj Jain	Chairman
Sanjib Datta	Managing Director
Rajesh Patel	Chief Financial Officer

Source: Company Website

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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