Sharekhan by BNP PARIBAS

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Mahanagar Gas Ltd

Q2 margin misses mark; Likely APM gas price cut key for margin recovery

Stock Update | Result Update

Oil & Gas		Sharekhan code: MGL	
Reco/View: Buy ↔	CMP: **Rs. 880**	Price Target: **Rs. 1,010** ↑	

↑ 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 Oct 08, 2022

High Risk

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

Source: Morningstar

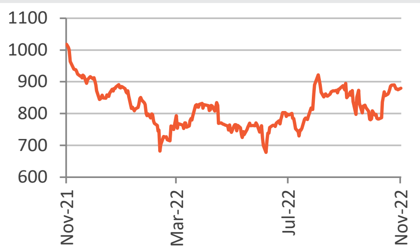
Company details

Market cap:	Rs. 8,693 cr
52-week high/low:	Rs. 1,025/666
NSE volume: (No of shares)	5.0 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	28.4
DII	15.6
Others	23.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	-1.2	18.8	-13.6
Relative to Sensex	2.5	-4.8	2.0	-15.1

Sharekhan Research, Bloomberg

Summary

- Q2FY23 PAT of Rs. 164 crore (down 11.5% q-o-q) was below our estimates due a sharp miss in EBITDA margin partially offset by higher other income. Gas sales volume of 3.5 mmscmd (flat q-o-q) was broadly in-line with our estimate.
- Miss of 19% in EBITDA margin at Rs7.9/scm (down 12.7% q-o-q) was on the account of contraction in I/C-PNG margin while CNG/D-PNG was stable-to-improving in Q2FY23. CNG/D-PNG volume was flat q-o-q at 2.5 mmscmd/0.5 mmscmd while I/C-PNG volume was up 2% q-o-q to 0.4 mmscmd.
- A likely cut in APM gas price or capping of domestic gas price could help CGD retain pricing power in CNG and act as key rating catalyst. Management guided for 6% volume CAGR over 3-5 years.
- We maintain our Buy rating on MGL with a revised PT of Rs. 1,010, noting its inexpensive valuation of 11x its FY2024E EPS (at a discount of 27% to three-year average PE of 15x) and expectation of 13% PAT CAGR over FY22-25E.

Mahanagar Gas Limited (MGL) reported weak Q2FY23 results with a sharp miss of 19%/21% in operating profit/PAT of Rs. 253 crore/Rs. 164 crores, down 11.5%/11.5% q-o-q due to lower-than-expected EBITDA margin while volumes were in-line with expectation. EBITDA margin of Rs. 7.9/scm (down 12.7% q-o-q) was 19% below our estimate of Rs. 9.8/scm as I/C-PNG margin got impacted due to decline in realizations because the benchmark alternate fuel price was down 20-25% q-o-q while gas cost witnessed upward trend along with INR depreciation against USD. CNG/D-PNG margin was a stable-to-improving trend in Q2FY23 supported by price hike and higher domestic gas allocation. Lower I/C-PNG margin led to 13% miss in gross margin at Rs.13/SCM (down 9.2% q-o-q). CNG/D-PNG volume was flat q-o-q at 2.5 mmscmd/0.5 mmscmd I/C-PNG volume was up 2% q-o-q to 0.4 mmscmd.

Key positives

- CNG/D-PNG price hiked by Rs9.5/kg and Rs5.5/scm respectively to Rs89.5/kg and Rs54/scm.

Key negatives

- Miss in gross/EBITDA margin at Rs. 13/Rs. 7.9 per scm, down 9%/13% q-o-q.
- Muted CNG/D-PNG sales volume at 3.5/0.5 mmscmd; flat q-o-q.

Management Commentary

- Management maintained volume CAGR guidance of 6% over 3-5 years.
- MGL is sourcing 7-10% of gas requirement for priority sector (CNG/D-PNG) through spot LNG while gas requirement for I/C-PNG is met fully through term LNG.
- UBP of $8.9/10.5 per mmbtu in July/Mid-August. From August 16, 2022, gas pooling system was discontinued, and gas cost was at $6.26/mmbtu (a combination of APM, CBM and HP-HT gas) and at $8.75/mmbtu currently.
- FY23 capex guidance of Rs650-800 crore versus capex of Rs300 crore in H1FY23.
- Current CNG/D-PNG price at Rs89.5/kg and Rs54/scm respectively. Marginal portion of gas price hike not passed on keeping in view petrol/diesel price. CNG vehicle addition declined to 15,500 in Q2FY23 versus 19,000 in Q1FY23.
- Current Industrial/commercial PNG price is in the range of Rs60-65/scm, which is largely similar to Q2FY23 level.

Revision in estimates – We have cut our FY23 earnings estimate to factor in lower margin assumption and fine-tuned the FY24 earnings estimate. We have introduced our FY25 earnings estimate.

Our Call

Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,010: Accommodative government policies and likely cut in APM gas price (Kirit Parikh committee already set up to review domestic gas pricing formula) or capping of domestic gas price would improve volume growth visibility and support sustained margin recovery for CGDs. We expect MGL's PAT to clock 13% PAT CAGR over FY22-25E, along with healthy RoE/RoCE of 19%/24%. MGL is the cheapest CGD stock with attractive valuation of 11x FY24E EPS, which is at a 27% discount to its 3-year average PE multiple. Hence, we maintain our Buy rating on MGL with a revised PT of Rs. 1,010.

Key Risks

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

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,560	6,100	5,616	5,936
OPM (%)	26.0	15.3	20.8	21.5
Adjusted PAT	597	623	791	869
% YoY growth	-3.7	4.3	26.9	9.9
Adjusted EPS (Rs.)	60.4	63.1	80.0	87.9
P/E (x)	14.6	14.0	11.0	10.0
P/B (x)	2.4	2.2	2.0	1.8
EV/EBITDA (x)	8.9	7.6	5.9	5.0
RoNW (%)	17.5	16.6	19.2	19.1
RoCE (%)	22.1	20.6	24.0	24.0

Source: Company; Sharekhan estimates

Weak Q2 performance; earnings missed estimates as margin disappoints

Operating profit of Rs. 253 crore (down 16.2% y-o-y; down 11.5% q-o-q) was 19% below our estimate of Rs313 crore primarily due to lower-than-expected EBITDA margin of Rs7.9/SCM (down 12.7% q-o-q and 19% below our estimate of Rs9.8/scm). Gas sales volume of 3.5 mmscmd (up 10.7% y-o-y; flat q-o-q) was in-line with our estimates. CNG/D-PNG volume was flat q-o-q at 2.5 mmscmd/0.5 mmscmd while I/C-PNG volume was up 2% q-o-q to 0.4 mmscmd. PAT at Rs164 crore (down 19.7% y-o-y; down 11.5% q-o-q) was 21% below our estimate of Rs208 crore due to sharp miss in margin.

Q2FY2023 conference call highlights

- **APM gas allocation and price:** MGL is sourcing 7-10% of the gas requirement for the priority sector (CNG and D-PNG) through spot LNG. UBP of $8.9/10.5 per mmbtu in July/Mid-August. From August 16, 2022, gas pooling system was discontinued, and gas cost was at $6.26/mmbtu (a combination of APM, CBM and HP-HT gas) and at $8.75/mmbtu currently. The company is waiting for the Kirit Parekh Committee report on gas pricing and is hopeful that the outcome will be favourable for GCDS.
- **Volume/margin outlook:** Management guided for volume CAGR of 6% over the next 3-5 years. MGL has passed on most of the gas cost hikes in Q2 and will take a calibrated approach in Q3, depending on how spot prices move. The company indicated that an increase in APM gas prices and rupee depreciation is a concern for margin.
- **Capex/CGD infrastructure**: Management has spent ~Rs. 300 crores in H1FY23 and expects Rs. 650-800 crores of Capex for FY23. Most of the capex is expected post-monsoon. Domestic PNG customers stood at 1.99 million (addition of 62,000 households q-o-q), steel pipeline of 6,325 km (addition of 39 km q-o-q), 296 CNG stations (added five new CNG station in Q2FY2023), and I/C customers at 4,427 as of September 30, 2022. The Raigad GA has 23 operational CNG stations.
- **CNG conversion and price gap with petrol:** Total CNG vehicle conversions stood at ~15,500 versus 19,000 in Q1FY2023. The break-up of vehicle addition – added 2,200 CVs, 11,300 private vehicles, 200 taxis and ~20 buses. Though CNG prices have risen, the price gap between CNG and petrol is ~40%.
- **Validity of term LNG contracts**: The company has one term contract ending in the next 7-8 months and the other 2 have validity of 5-6 years. Total contracted LNG volume is at 0.56 mmscmd (excluding 0.1 mmscmd from domestic HP-HT gas).

Results Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**1,563**	**830**	**88.2**	**1,455**	**7.4**
Total Expenditure	1,310	528	147.9	1,169	12.0
Reported operating profit	**253**	**302**	**-16.2**	**286**	**-11.5**
Other Income	26	23	15.0	20	29.8
Interest	2	2	22.3	2	7.9
Depreciation	55	47	16.5	54	2.6
PBT	221	275	-19.6	250	-11.4
Tax	57	71	-19.1	64	-11.0
Reported PAT	**164**	**204**	**-19.7**	**185**	**-11.5**
Equity Cap (cr)	10	10		10	
Reported EPS (Rs)	16.6	20.7	-19.7	18.7	-11.5
Margins (%)			**BPS**		**BPS**
OPM	16.2	36.4	-2017.0	19.6	-344.9
NPM	10.5	24.6	-1411.6	12.7	-223.8
Tax rate	25.9	25.7	16.3	25.8	9.1

Source: Company, Sharekhan Research

Key operating performance

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Volume (mmscmd)	3.5	3.1	10.7	3.4	0.3
Gross margin (Rs/scm)	13.0	15.6	-16.3	14.4	-9.2
EBITDA margin (Rs/scm)	7.9	10.5	-24.3	9.1	-12.7
CNG volume (mmscmd)	2.5	2.2	13.7	2.5	0.1
Domestic PNG volume (mmscmd)	0.5	0.5	4.3	0.5	0.3
I/C PNG volume (mmscmd)	0.4	0.4	1.8	0.4	1.8

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’s gas demand for the next 4-5 years. However, high spot LNG prices, the recent steep hike in APM gas price fand indication of faster adoption of EVs is a cause of concern for CGDs. We highlight here that a potential capping of the domestic gas price at the current level could remove overhang of high cost and margin

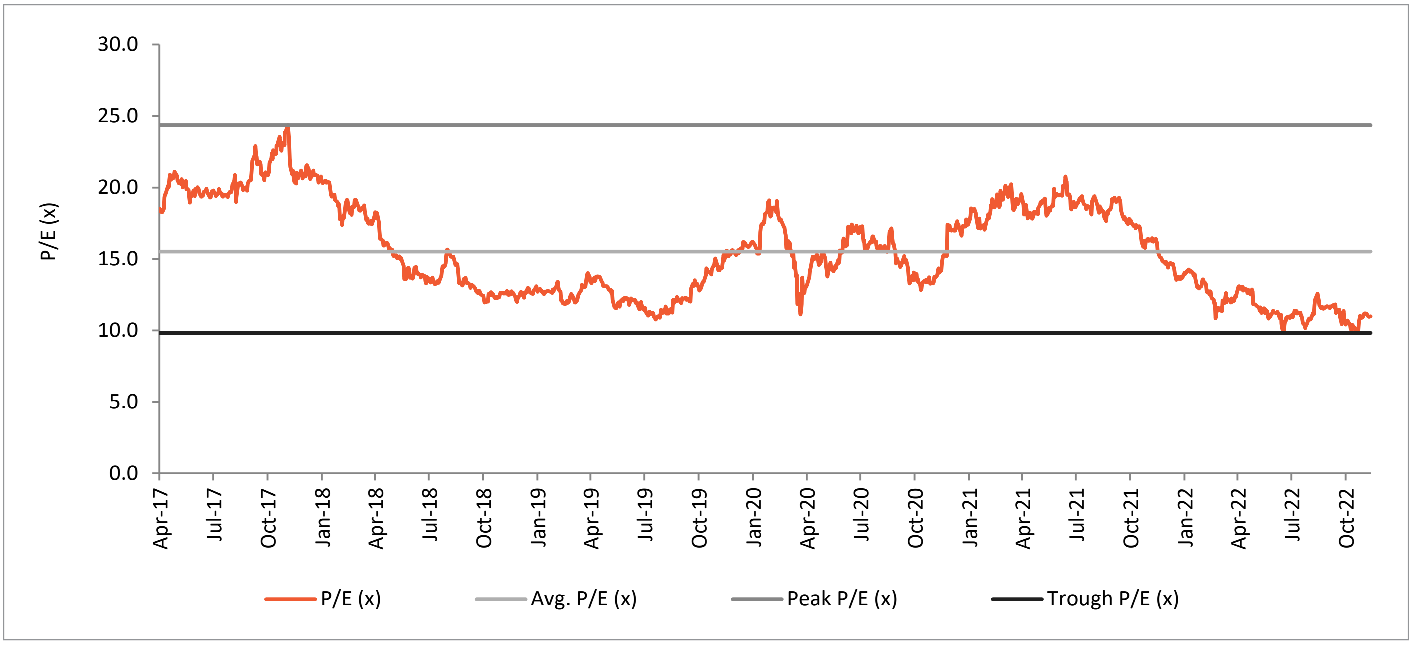
■ Company outlook - Volume and margin recovery to drive decent earnings growth

Setting-up of new CNG station in existing Mumbai GA and ramp-up at Raigad GA would drive a 7% volume CAGR over FY2022-FY2025E. We expect EBITDA margin to decline by 7% y-o-y to Rs. 7.8/scm in FY23, given high gas cost. Margin would gradually increase to Rs. 9.2/Rs9.5 per scm in FY2024E/FY2025E versus our estimate of Rs. 7.8/scm in FY2023 supported by price hike and potential normalization 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-FY2025E on low base of FY2022.

■ Valuation - Maintain Buy on MGL with a revised PT of Rs. 1,010

Accommodative government policies and likely cut in APM gas price (Kirit Parikh committee already set up to review domestic gas pricing formula) or capping of domestic gas price would improve volume growth visibility and support sustained margin recovery for CGDs. We expect MGL’s PAT to clock 13% PAT CAGR over FY22-25E, along with healthy RoE/RoCE of 19%/24%. MGL is the cheapest CGD stock with attractive valuation of 11x FY24E EPS, which is at a 27% discount to its 3-year average PE multiple. Hence, we maintain our Buy rating on MGL with a revised PT of Rs. 1,010.

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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