Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Mahanagar Gas Ltd

Subdued Q3; gas price capping to drive earnings recovery

Oil & Gas		Sharekhan code: MGL		
Reco/View: Buy	↔	CMP: Rs. 850	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 Dec 08, 2022

High Risk

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

Source: Morningstar

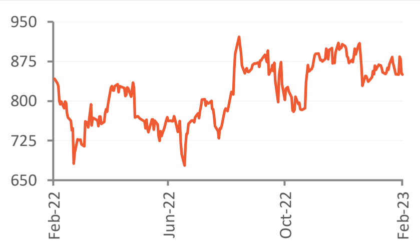
Company details

Market cap:	Rs. 8,396 cr
52-week high/low:	Rs. 925/666
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	29.7
DII	15.6
Others	22.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.1	-4.5	8.8	0.9
Relative to Sensex	-0.4	-4.3	4.5	-2.8

Sharekhan Research, Bloomberg

Summary

- Q3FY23 PAT of Rs. 172 crore (up 5% q-o-q) was 18% below our estimates due a 3%/17% miss in volume/EBITDA margin at 3.4 mmscmd/Rs. 8.2 per mmbtu partially offset by higher other income and slightly lower tax rate.
- Recently government has given top priority to CGDs for bidding of HP-HT gas, and this would help CGDs replace expensive spot LNG from gas sourcing mix. Also, the Kirit Parikh committee recommendations on capping of APM gas is expected to get approved before March 2023. This would reduce gas cost and remove high gas cost overhang for CGDs.
- A likely lower gas cost would drive recovery in volume/margin for CGDs from FY24. MGL guided for 5-6% volume CAGR over next 3-5 years and we expect EBITDA margin improvement to >Rs. 9/scm versus Rs8.2/scm in Q3FY23. Hence, we expect MGL's PAT to clock 15% PAT CAGR over FY22-25E with improvement in RoE to 20%.
- We maintain our Buy on MGL with an unchanged PT of Rs. 1,010, noting its inexpensive valuation of 10.1x its FY2024E EPS (at a discount of 32% to three-year average PE of 15x) and expectation of strong earnings recovery.

Mahanagar Gas Limited (MGL) reported weak Q3FY23 results with a sharp miss of 20%/18% in operating profit/PAT of Rs. 256 crore/Rs. 172 crore, up 1%/5% q-o-q as gas sales volume/EBITDA margin was 3%/17% below our estimate. Gas sales volume declined by 1.4% q-o-q (versus expectation of 1.7% q-o-q growth) to 3.4 mmscmd as CNG/I-C PNG witnessed 2.6%/1.8% q-o-q fall to 2.5 mmscmd/0.4 mmscmd while D-PNG volume was up 5.9% q-o-q to 0.5 mmscmd. EBITDA margin increased by 3% q-o-q to Rs. 8.2/scm but sharply missed our estimate of Rs9.8/scm as increase in gas cost (up 10% q-o-q) and per unit opex (up 9% q-o-q) was much higher as compared t to the rise in blended realisations (up 8% q-o-q).

Key positives

- Improved economics of CNG versus petrol in Mumbai with discount of 45% post recent CNG price cut.

Key negatives

- Miss of 9%/17% in gross/EBITDA margin at Rs. 13.7/Rs. 8.2 per scm, up 5.2%/2.7% q-o-q.
- Miss in CNG/I-C PNG sales volume at 2.5/0.4 mmscmd; down 2.6%/1.8% q-o-q.

Management Commentary

- The management maintained volume CAGR guidance of 5-6% over 3-5 years and see upside to growth guidance in case of lower CNG price. Raigad GA has volume potential of 0.6 mmscmd.
- Recent government notification has given top priority to CGDs in bidding of HP-HT gas. Thus, CGDs would get majority of the 10% shortfall in AGM gas allocation from HP-HT gas and replace expensive spot LNG. MGL is getting 0.27 mmscmd of HP-HT gas from February 01, 2023
- Management expects Kirit Parikh committee recommendation on domestic gas price to be approved by the government before end of March 2023. Likely APM gas price cap of $6.5/mmbtu and priority in HP-HT gas to lower gas costs.
- CNG price is at a 45%/9% discount to petrol/diesel currently post considering recent Rs2.5/kg cut in CNG price.
- FY23/FY24 capex guidance of Rs650 crore/Rs600-800 crore. 9MFY23 capex at Rs460-475 crore.

Revision in estimates – We have fine-tuned our FY23-25 earnings estimate to factor in 9MFY23 results.

Our Call

Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 1,010: Supportive government policies to cap domestic gas price and a potential normalisation of international gas prices would remove high gas cost overhang and drive margin recovery for CGDs over FY24-25. We expect MGL's PAT to clock 15% PAT CAGR over FY22-25E, along with healthy RoE/RoCE of 20%/25%. MGL is the cheapest CGD stock with attractive valuation of 10.1x/9.2x FY24E/FY25E EPS. Hence, we maintain a Buy rating on MGL with an unchanged 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 prices and adverse regulatory changes could affect outlook and valuations.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,560	6,389	5,869	6,206
OPM (%)	26.0	16.0	21.1	21.7
Adjusted PAT	597	665	834	915
% YoY growth	-3.7	11.4	25.4	9.7
Adjusted EPS (Rs.)	60.4	67.3	84.4	92.6
P/E (x)	14.1	12.6	10.1	9.2
P/B (x)	2.3	2.1	1.9	1.7
EV/EBITDA (x)	8.6	6.7	5.4	4.7
RoNW (%)	17.5	17.6	20.0	19.8
RoCE (%)	22.1	22.2	25.3	25.2

Source: Company; Sharekhan estimates

Weak Q3 results; volume/margin miss estimate

Q3FY23 results saw a sharp miss of 20%/18% in operating profit/PAT of Rs. 256 crore/Rs. 172 crore, up 1%/5% q-o-q as gas sales volume/EBITDA margin was 3%/17% below our estimate. Gas sales volume declined by 1.4% q-o-q (versus expectation of 1.7% q-o-q growth) to 3.4 mmscmd as CNG/I-C PNG witnessed 2.6%/1.8% q-o-q fall to 2.5 mmscmd/0.4 mmscmd while D-PNG volume was up 5.9% q-o-q to 0.5 mmscmd. EBITDA margin increased by 3% q-o-q to Rs. 8.2/scm but sharply missed our estimate of Rs9.8/scm as increase in gas cost (up 10% q-o-q) and per unit opex (up 9% q-o-q) was much higher as compared t to the rise in blended realisations (up 8% q-o-q).

Key Conference call takeaways

- **CGDs top priority for HP-HT gas bidding –** The recent government notification has given top priority to CGDs in bidding of HP-HT gas. Thus, CGDs would get majority of 10% shortfall in AGM gas allocation from HP-HT gas and replace expensive spot LNG. MGL is getting 0.27 mmscmd of HP-HT gas from Feb 01, 2023. Alspo
- **Update on Kirit Parekh gas pricing recommendations:** The management expects the government to approve the recommendation of the Kirit Parekh committee by end of March 2023. APM gas price capping of $6.5mmbtu for FY24) if implemented from April 2023 would lower gas cost by ~$2/mmbtu for CNG /D-PNG requirement.
- **Volume guidance:** The management has guided for volume CAGR of 5-6% over the next 3-5 years. Management hinted that volume growth could be higher if gas price declines with the implementation of the Kirit Parikh committee report. MGL's GA1/GA2/GA3 are expected to witness volume growth of 5%/10-15%/20%. Management guided for volume potential of 0.6 mmscmd from Raigad GAs (current volume of 0.1-0.12 mmscmd).
- **Capex/CGD infrastructure –** The management has spent ~Rs. 460-475 crores in 9MFY23 and guided for Rs. 650 crore/Rs.600-800 crore of capex for FY23/FY24 with majority of capex would be in GA2/GA2. Domestic PNG customers stood at 2.08 million (addition of 87,745 households q-o-q), steel pipeline of 6,407 km (addition of 72 km q-o-q), 301 CNG stations (added five new CNG station in Q3FY2023), and I/C customers at 4,460 as on December 31, 2022. The Raigad GA has 24 operational CNG stations.
- **CNG conversion and price gap with petrol –** Total CNG vehicle conversions stood at 16,900 versus 15,500 in Q2FY23. The break-up of vehicle addition – 1,700 LCVs, 12,200 car/taxi, 2900 3-W and 33 trucks. The price gap between CNG and petrol improved to 45% (versus ~40% earlier) post the recent Rs2.5/kg cut in CNG prices in Mumbai with effect from February 01, 2023.
- **Others –** 1) Efforts are being made by gas producers to connect some isolated fields to main gas grid and thus more APM gas would be made available to CGDs, 2) Volumes were largely flat in January 2023.

Results Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	**1,671**	**1,028**	**62.6**	**1,563**	**7.0**
Total Expenditure	1,415	925	53.1	1,310	8.1
Operating profit	**256**	**103**	**148.4**	**253**	**1.3**
Other Income	32	22	47.7	26	24.1
Interest	2	2	57.1	2	-2.0
Depreciation	59	48	21.4	55	6.2
PBT	227	75	202.5	221	2.8
Tax	55	18	200.9	57	-3.4
Reported PAT	**172**	**57**	**203.0**	**164**	**4.9**
Equity Cap (cr)	10	10		10	
Reported EPS (Rs.)	17.4	5.7	203.0	16.6	4.9
Margins (%)			**BPS**		**BPS**
OPM	15.3	10.0	529.1	16.2	-85.8
NPM	10.3	5.5	477.0	10.5	-19.8
Tax rate	24.3	24.5	-13.0	25.9	-155.8

Source: Company, Sharekhan Research

Key operating performance

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Volume (mmscmd)	3.4	3.3	3.3	3.5	-1.4
Gross margin (Rs. /scm)	13.7	8.6	58.8	13.0	5.2
EBITDA margin (Rs. /scm)	8.2	3.4	140.5	7.9	2.7
CNG volume (mmscmd)	2.5	2.4	3.5	2.5	-2.6
Domestic PNG volume (mmscmd)	0.5	0.5	5.4	0.5	5.9
I/C PNG volume (mmscmd)	0.4	0.4	0.1	0.4	-1.8

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Supportive policies to remove high gas cost overhang for CGDs; APM gas allocation/threat of EVs a concern

Capping of domestic gas price at $6.5/mmbtu (versus $8.6/mmbtu for H2FY23) could remove gas cost overhang for CGDs in FY24. Further, a potential normalisation of international gas price from FY25 would mean APM gas price could remain in the range of $4-6.5/mmtu. This would improve volume growth visibility (supported by widening of pricing gap between CNG versus petrol) and sustained margin recovery for CGDs and with high exposure to CNG/D-PNG. Moreover, India's long-term gas demand potential is very strong, given regulatory support to curb pollution. 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. Having said that, with rising volumes, CGDs would have to source incremental gas requirement from either through HP-HT gas or expensive spot LNG as a likely increase in APM gas allocation would be difficult task. Moreover, a gradual shift towards EVs could impact CNG volume growth potential in the long term.

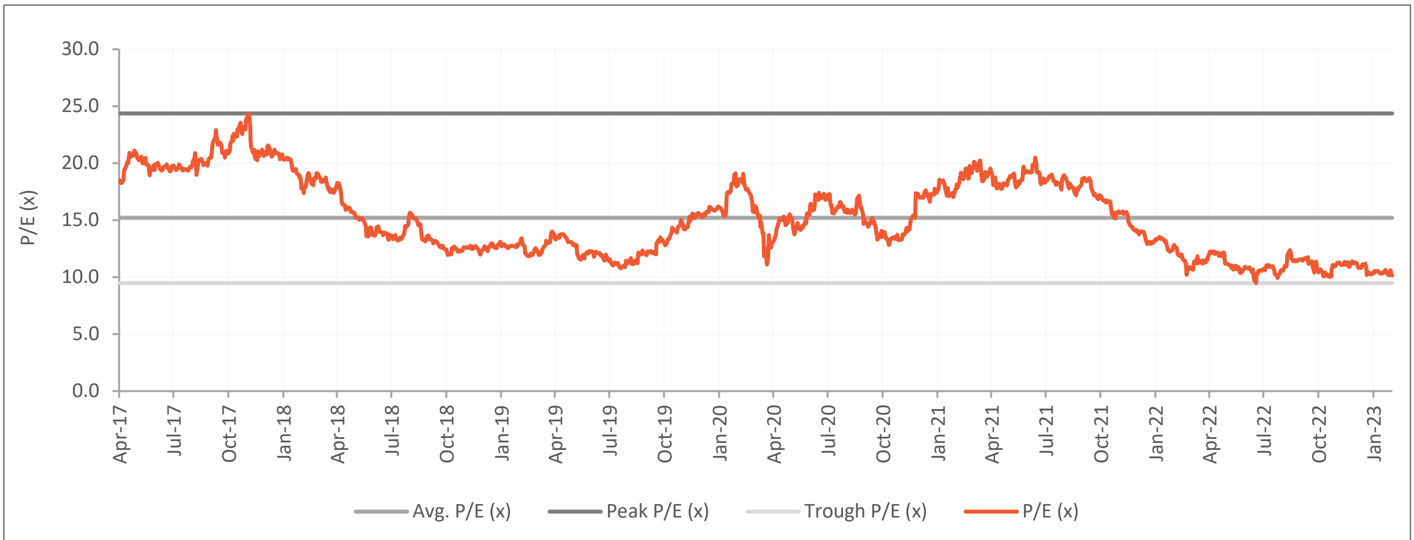
■ Company Outlook – Volume and margin recovery to drive decent earnings growth

Setting-up of new CNG station in existing Mumbai GA and ramp-up at Raigad GA would drive a 9% volume CAGR over FY2022-FY2025E. A domestic gas price cap of $6.5/mmbtu would reduce gas cost by ~$2.1/mmbtu in FY24E for priority sector of CNG/D-PNG and thus we expect margin recovery to Rs. 9.1/Rs. 9.4 per scm in FY24E/FY25E as compared our estimate of Rs. 8.1/scm (a 4% y-o-y decline) in FY23. Double digit volume growth and margin recovery would drive 13%/15% EBITDA/PAT CAGR over FY22-25E

■ Valuation – Maintain Buy on MGL with an unchanged PT of Rs. 1,010

Supportive government policies to cap domestic gas price and a potential normalisation of international gas prices would remove high gas cost overhang and drive margin recovery for CGDs over FY24-25. We expect MGL's PAT to clock 15% PAT CAGR over FY22-25E, along with healthy RoE/RoCE of 20%/25%. MGL is the cheapest CGD stock with attractive valuation of 10.1x/9.2x FY24E/FY25E EPS. Hence, we maintain a Buy rating on MGL with an unchanged 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 301 CNG stations, 2.03 million PNG customers, and a pipeline network of 6,407 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 (0.6 mmscmd volume potential) would further add to the company's volume growth prospects. Kirit Parikh committee recommendations to cap APM gas price at $6.5/mmbtu would remove high gas cost overhang for CGDs and drive volume/margin recovery over FY24-25. MGL is the cheapest CGD stock.

Key Risks

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

Additional Data

Key management personnel

Mahesh Vishwanathan Iyer	Chairman
Ashu Shinghal	Managing Director
Sanjay Shende	Deputy Managing Director
Rajesh Patel	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	State of Maharashtra	10
2	Life Insurance Corp of India	8.32
3	FMR LLC	6.59
4	Vontobel Holding AG	5.09
5	Schroders PLC	3.77
6	Fidelity Investment Trust	3.7
7	Government PENSI	1.91
8	Vanguard Group Inc.	1.89
9	Aberdeen Standard OEIC II	1.42
10	HDFC Life Insurance Co Ltd.	1.18

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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