

3 February 2023

Mahanagar Gas

Muted volume growth; on attractive valuations, maintaining a Buy

Mahanagar Gas was hit by lower CNG volume growth in Q3 due to higher gas prices. The gross margin improved despite increase in APM gas prices, which the company passed on. The company was expecting the Kirit Parikh Committee to reduce APM gas prices; this did not come through. It hiked prices in Oct'22 (from Rs80/kg to Rs86) and in Nov'22 (to Rs89.5), which, with falling crude and spot LNG prices, would improve spreads in Q4. We retain a Buy rating on the stock with an unchanged TP of Rs1,090, at 11x FY25e EPS.

In line EBITDA spreads, volume growth disappoints. Q3 FY23 EBITDA at Rs2.56bn was up 148% y/y, 1.3% q/q. PAT at 1.72bn was up 202% y/y, 4.9% q/q. The performance was slightly lower than we estimated on lower volume growth while EBITDA spreads were in line. Overall volumes at 3.41mmcsmd (vs our estimated 3.51) were up 3.3% y/y, down 1.4% q/q. CNG volumes at 2.47mmcsmd (vs our estimated 2.59) were up 3.5% y/y, down 2.6% q/q. D-PNG volumes at 0.50mmcsmd were up 5.4% y/y, 5.9% q/q. Industrial and commercial sales were 0.44mmcsmd, flat y/y, down 1.4% q/q. The gross margin was Rs13.7/scm, up 58.8% y/y, 5.2% q/q. The EBITDA spread at Rs8.16/scm was up 140% y/y, 2.7% q/q, improving on price hikes, more than the increase in gas (input) costs. CNG prices were up Rs7.47/kg q/q while D-PNG was up Rs4.21/scm.

Outlook, Valuation. We expect EBITDA spreads of Rs9.5/scm in FY24 and Rs10 in FY25. We prefer Indraprastha Gas to Mahanagar Gas and Gujarat Gas; all three would further benefit from lower gas prices, after Cabinet approval of the Kirit Parikh Committee recommendations. The stock trades at 9.6x/8.6x FY24e/FY25e PE. We maintain a Buy, with a TP of Rs1,090. **Risks:** Slower volume growth, margin compression on smaller differences than alternatives, regulatory changes, higher LNG prices, slower infrastructure rollout, competition from alternative fuels like electricity for vehicles.

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	21,525	35,602	52,478	50,722	54,517
Net profit (Rs m)	6,196	5,970	6,873	8,787	9,790
EPS (Rs)	62.7	60.4	69.6	88.9	99.1
P/E (x)	18.6	12.9	12.2	9.6	8.6
EV / EBITDA (x)	10.7	6.7	6.5	5.3	4.7
P/BV (x)	3.6	2.1	2.1	1.9	1.7
RoE (%)	20.0	17.5	18.1	20.8	20.9
RoCE (%)	19.2	16.7	17.2	19.8	20.0
Dividend yield (%)	2.3	2.8	3.3	5.2	5.8
Net debt / equity (x)	-0.5	-0.4	-0.4	-0.4	-0.3

Source: Company, Anand Rathi Research

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Rating: Buy

Target Price: Rs.1090

Share Price: Rs.850

Key data	MAHGL IN / MGAS.BO
52-week high / low	Rs.925 / 666
Sensex / Nifty	60842 / 17854
3-m average volume	\$3.9m
Market cap	Rs.84bn / \$1,026.4m
Shares outstanding	99m

Shareholding pattern (%)	Dec'22	Sep'22	Jun'22
Promoters	32.50	32.50	32.50
- of which, Pledged	-	-	-
Free float	67.50	67.50	67.50
- Foreign institutions	29.73	28.37	25.81
- Domestic institutions	15.61	15.57	16.05
- Public	22.16	23.56	25.64

Estimates revision (%)	FY23e	FY24e	FY25e
Sales	0	3	4
EBITDA	-14	-1	0
PAT	-16	-1	0

Relative price performance



Source: Bloomberg

Harshraj Aggarwal
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Net revenues	21,525	35,602	52,478	50,722	54,517
Growth (%)	-27.6	65.4	47.4	-3.3	7.5
Direct costs	8,348	21,287	36,250	31,171	32,774
SG&A	3,837	5,072	5,883	6,589	7,380
EBITDA	9,340	9,243	10,346	12,962	14,363
EBITDA margins (%)	43.4	26.0	19.7	25.6	26.3
- Depreciation	1,737	1,963	2,061	2,164	2,272
Other income	805	857	900	945	993
Interest expenses	72	75	-	-	-
PBT	8,336	8,063	9,185	11,743	13,083
Effective tax rate (%)	25.7	26.0	25.2	25.2	25.2
+ Associates / (Minorities)					
Net income	6,196	5,970	6,873	8,787	9,790
Adjusted income	6,196	5,970	6,873	8,787	9,790
WANS	99	99	99	99	99
FDEPS (Rs / sh)	62.7	60.4	69.6	88.9	99.1

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	988	988	988	988	988
Net worth	32,324	35,973	40,097	44,491	49,386
Debt	-	-	-	-	-
Minority interest					
DTL / (Assets)	1,773	2,008	2,008	2,008	2,008
Capital employed	34,096	37,981	42,105	46,499	51,394
Net tangible assets	20,409	24,581	28,276	33,112	37,840
Net intangible assets	57	52	52	52	52
Good will					
CWIP (tang. & intang.)	5,603	6,159	6,159	6,159	6,159
Investments (strategic)	-	-	-	-	-
Investments (financial)	10,250	10,883	10,883	10,883	10,883
Current assets (excl. cash)	4,574	6,011	7,014	6,909	7,135
Cash	5,119	4,652	6,058	5,037	5,183
Current liabilities	11,915	14,357	16,337	15,654	15,858
Working capital	-7,341	-8,346	-9,323	-8,744	-8,723
Capital deployed	34,096	37,981	42,105	46,499	51,394
Contingent liabilities	-	-	-	-	-

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT (Adj. OI and interest)	7,603	7,281	8,285	10,798	12,091
+ Non-cash items	1,737	1,963	2,061	2,164	2,272
Oper. prof. before WC	9,340	9,243	10,346	12,962	14,363
- Incr. / (decr.) in WC	-791	-1,005	-977	579	21
Others incl. taxes	-2,093	-2,312	-2,956	-3,293	-
Operating cash-flow	12,224	12,560	14,279	15,676	14,342
- Capex (tang. + intang.)	3,632	6,686	5,756	7,000	7,000
Free cash-flow	8,592	5,874	8,523	8,676	7,342
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	1,927	2,322	2,749	4,394	4,895
+ Equity raised	-	-	-	-	-
+ Debt raised	-	-	-	-	-
- Fin investments	-965	633	-	-	-
- Misc. (CFI + CFF)	739	-784	-900	-945	-993
Net cash-flow	6,891	3,703	6,674	5,228	3,439

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	18.6	12.9	12.2	9.6	8.6
EV/EBITDA (x)	10.7	6.7	6.5	5.3	4.7
EV/sales (x)	4.6	1.7	1.3	1.3	1.2
P/B (x)	3.6	2.1	2.1	1.9	1.7
RoE (%)	20.0	17.5	18.1	20.8	20.9
RoCE (%) - After tax	19.2	16.7	17.2	19.8	20.0
ANDA filings					
DPS (Rs per share)	19.5	23.5	27.8	44.5	49.5
Dividend yield (%)	2.3	2.8	3.3	5.2	5.8
Dividend payout (%) - Inc. DDT	31.1	38.9	40.0	50.0	50.0
Net debt/equity (x)	-0.5	-0.4	-0.4	-0.4	-0.3
Receivables (days)	22	19	19	19	19
Inventory (days)	4	3	3	3	3
Payables (days)	26	28	33	29	28
CFO:PAT%	197.3	210.4	207.7	178.4	146.5

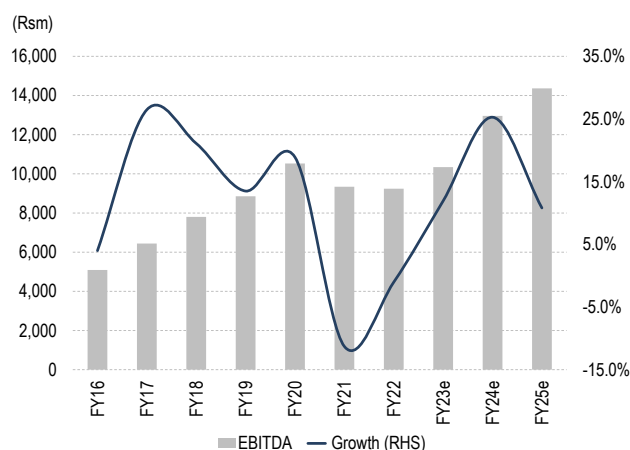
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBITDA growth



Source: Company, Anand Rathi Research

Result Highlights

Fig 7 – Quarterly trend

Particulars	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Y/Y (%)	Q/Q (%)
Net sales	2,618	5,067	6,664	7,177	6,155	8,301	10,278	10,868	14,548	15,627	16,714	132.9	-6.5
EBITDA	800	2,211	3,167	3,162	3,040	3,018	1,031	2,155	2,856	2,528	2,561	-19.0	-1.3
EBITDA margin (%)	30.6	43.6	47.5	44.1	49.4	36.4	10.0	19.8	19.6	16.2	15.3		
Other income	245	184	204	172	186	226	220	227	200	260	323	87.8	-19.4
Interest	15	20	17	19	17	20	15	23	23	25	24		
Depreciation	423	425	441	448	453	473	482	555	537	551	585	30.5	-5.9
PBT	607	1,950	2,913	2,866	2,756	2,751	753	1,804	2,496	2,213	2,274	-20.6	-2.7
Tax	155	507	741	738	716	708	184	486	644	573	553	-25.0	3.5
Adjusted PAT	453	1,443	2,172	2,128	2,041	2,043	569	1,318	1,852	1,640	1,721	-19.1	-4.7
NPM (%)	17.3	28.5	32.6	29.6	33.2	24.6	5.5	12.1	12.7	10.5	10.3		
EPS (Rs)	4.6	14.6	22.0	21.5	20.7	20.7	5.8	13.3	18.7	16.6	17.4	-19.1	-4.7

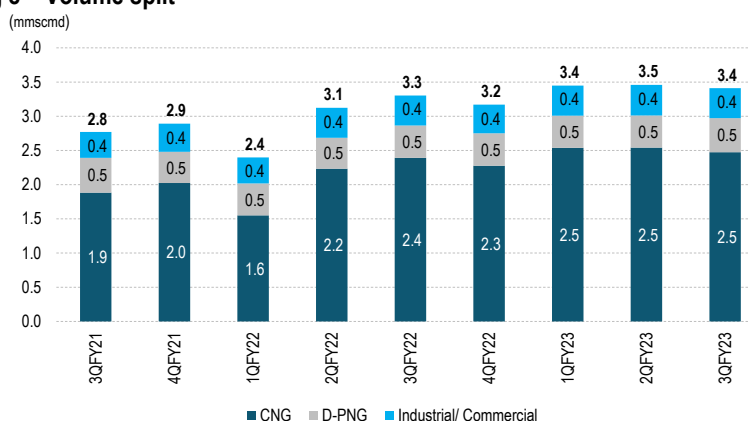
Source: Company, Anand Rathi Research

Key highlights

Performance EBITDA at Rs2.56bn was up 148% y/y, 1.3% q/q. PAT at 1.72bn was up 202% y/y, 4.9% q/q. The overall performance was slightly lower than our estimates on lower volume growth while EBITDA spreads were in line with our estimates. The performance, when compared to consensus, was in line, but still volumes disappointed.

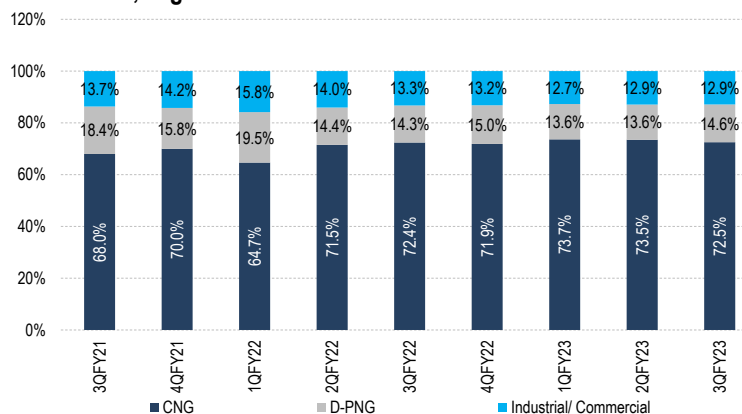
Volumes at 3.41mmscmd (vs our estimated 3.51) were up 3.3% y/y, down 1.4% q/q. CNG volumes at 2.47mmscmd (vs our estimated 2.59) were up 3.5% y/y, down 2.6% q/q. D-PNG volumes at 0.50mmscmd were up 5.4% y/y, 5.9% q/q. Industrial and commercial sales were 0.44mmscmd, flat y/y, down 1.4% q/q.

Fig 8 – Volume split



Source: Company, Anand Rathi Research

Fig 9 – Volumes, segment-wise



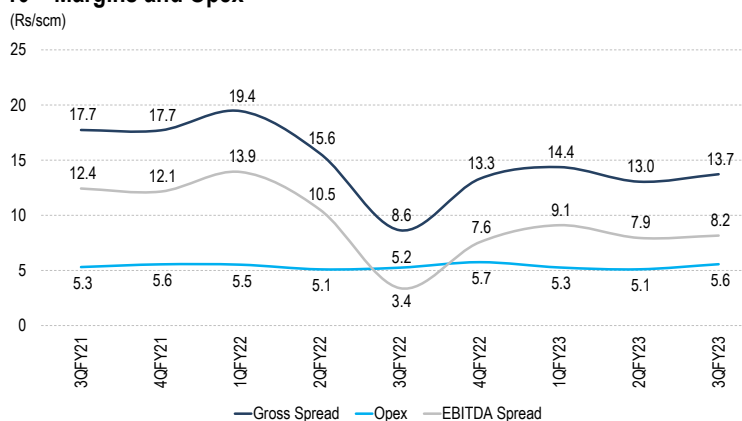
Source: Company, Anand Rathi Research

Despite the cost of gas being 58% higher y/y, 9.6% q/q, relentless price hikes expanded the gross margin, to Rs13.7/scm, up 58.8% y/y, 5.2% q/q.

Opex at Rs5.6/scm was 6% higher y/y, 9.1% q/q, with other operating expenses up 11% y/y, 17% q/q.

The EBITDA spread, at Rs8.16/scm, was up 140% y/y, 2.7% q/q, improving due to relentless price hikes, more than the increase in gas (input) costs. CNG prices were up Rs7.47/kg q/q while D-PNG was up Rs4.21/scm.

Fig 10 – Margins and Opex



Source: Company, Anand Rathi Research

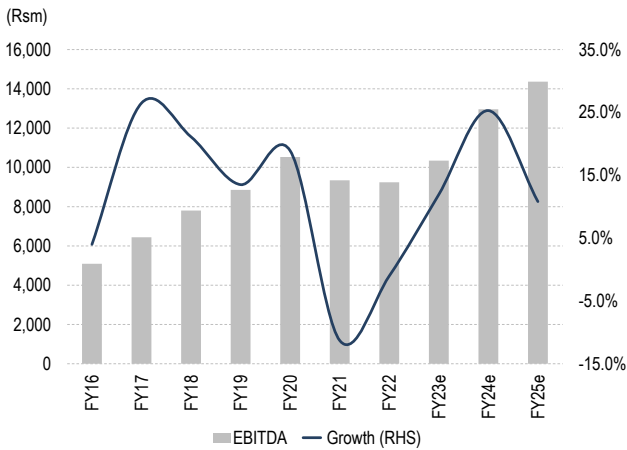
The Board declared an **interim dividend** of Rs10/sh (9M FY23 EPS at Rs52/sh).

Concall Highlights

- **Connections.** The company added 87,845 household connections (total 2.08m), five CNG stations (total 301), 6,407km of steel pipelines, and 82 industrial and commercial customers (total: 4,465).
- **Volumes.** Industrial volumes were 0.318mmscmd; commercial, 0.121mmscmd (total 0.44mmscmd).
- **Conversion.** CNG conversions at 16,900 a quarter are still strong (taxi/private 12,200, LCVs 1,700, 3Ws 2,900, trucks 33). Besides, the company secured a contract from the MSRTC to convert 800 buses from diesel to CNG, of which ~300-400 fall under the geographical area of Mahanagar Gas, expected to be added in the next 1-2 years.
- **Gas sourced.** APM volumes of 91%; the rest, spot and term contracts. The company highlighted that the term-contract supply was short, so spot volumes were sourced to address demand. Spot volume were 0.33mmscmd.
- **Gas allocation.** APM gas allocation was 91%, but the company expects increased HP/HT supply. It has started to source 0.3mmscmd of this from IGX from Feb'23. RIL has started to sell KG-basin volumes on IGX, available only for CGD. IGX volumes at 3mmscmd, of which 10% (0.3mmscmd) sourced by the company.
- **Raigad GA.** Raigad household connections were 63,539 and CNG stations (currently operational), 24. The company added 8km of pipeline totalling 373km. The first online station awaits approval; good growth expected.
- **Volume guidance.** Guidance of a 5-6% CAGR for the next five years. However, if the Kirit Parikh Committee proposal is approved (reducing gas prices) growth could be higher.
- **GA volume breakup and growth guidance.** GA1 Q3 sales at ~1.85mmscmd, expected to grow ~5% for the next two years, GA2 at ~1.55mmscmd to grow ~10%, GA3 at ~0.12mmscmd, expected growth ~20%. Raigarh (GA3) addressable market is 0.6mmscmd in the next five years.
- **Capex guidance.** 9M FY23 capex at Rs4.6bn (FY23 target Rs 6.5bn). FY24 capex targeted at Rs6bn-8bn.

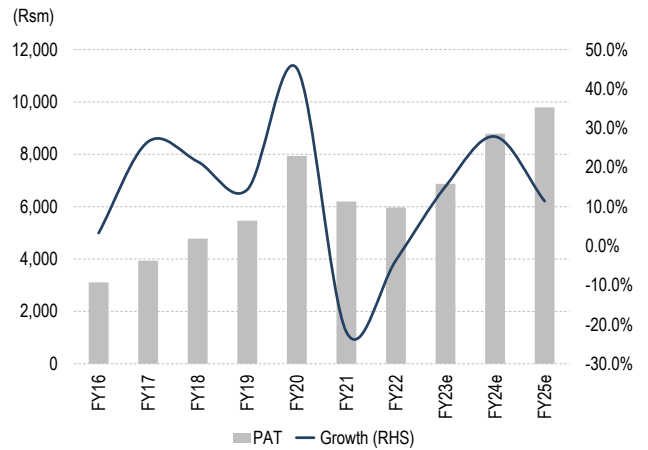
Key Charts

Fig 11 – EBITDA Growth



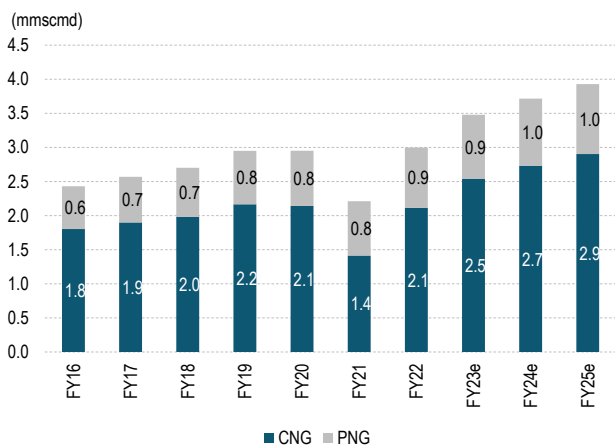
Source: Company, Anand Rathi Research

Fig 12 – PAT growth



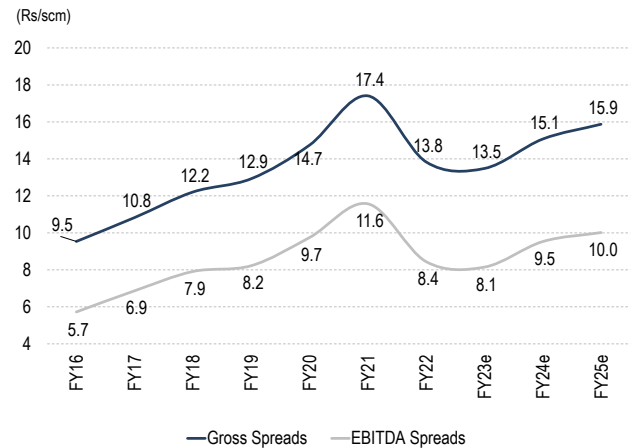
Source: Company, Anand Rathi Research

Fig 13 – Volumes



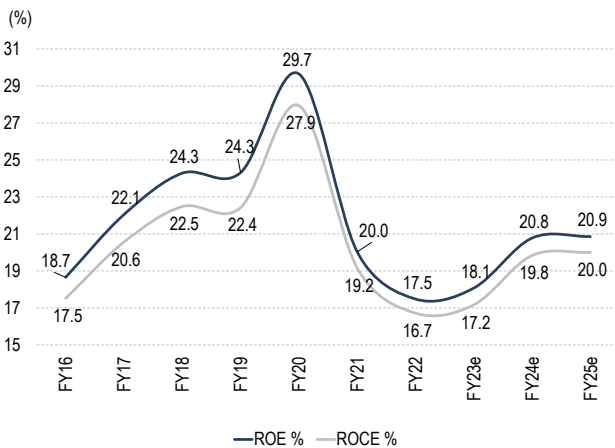
Source: Company, Anand Rathi Research

Fig 14 – EBITDA spreads



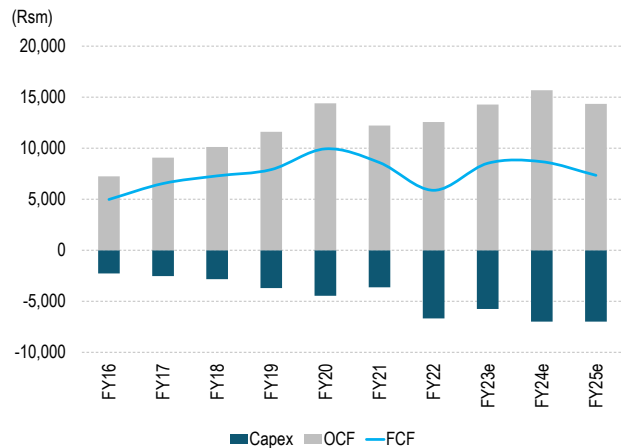
Source: Company, Anand Rathi Research

Fig 15 – Return ratios



Source: Company, Anand Rathi Research

Fig 16 – Free cash-flows



Source: Company, Anand Rathi Research

Valuations

Mahanagar Gas' CNG sales volumes are now well above pre-Covid levels along with vehicle conversions per month of ~6,000. We expect stations added and debottlenecking to drive CNG sales over the next three years, conservatively modelling 25 stations added a year, per management guidance. Management also said potential demand from MMR/Raigad would support 5-6% growth in the next 5-6 years. The company is a play on increased gas use from rising vehicles and PNG penetration. We like the business because of its dominant share in the growing markets of Mumbai and its suburbs.

The net cash position is strong with lower capex and better earnings through our forecast period, along with our projected robust FCF outlook. We see an upside to the company's current ~40% dividend pay-out.

Fig 17 – Change in estimates

(Rs m)	Old			New			% change		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23	FY24	FY25
Revenue	52,712	49,209	52,605	52,478	50,722	54,517	0	3	4
EBITDA	12,065	13,101	14,365	10,346	12,962	14,363	-14	-1	0
PAT	8,160	8,892	9,792	6,873	8,787	9,790	-16	-1	0

Source: Anand Rathi Research

We expect EBITDA spreads of Rs9.5/scm in FY24 and Rs10 in FY25. We prefer Indraprastha Gas to Mahanagar Gas and Gujarat Gas; all three would further benefit from lower gas prices, after Cabinet approval of the Kirit Parikh Committee recommendations. The stock trades at 9.6x/8.6x FY24e/FY25e PE. We maintain a Buy, with an unchanged target of Rs1,090.

Sensitivity matrix (FY25e)

Fig 18 – EBITDA sensitivity

Volume growth %	EBITDA (Rs bn)						
	-0.6%	1.4%	3.4%	5.4%	7.4%	9.4%	
8.5	11.5	11.8	12.0	12.2	12.4	12.7	
9.0	12.2	12.4	12.7	12.9	13.2	13.4	
9.5	12.9	13.1	13.4	13.7	13.9	14.2	
10.0	13.6	13.8	14.1	14.4	14.6	14.9	
10.5	14.2	14.5	14.8	15.1	15.4	15.7	
11.0	14.9	15.2	15.5	15.8	16.1	16.4	

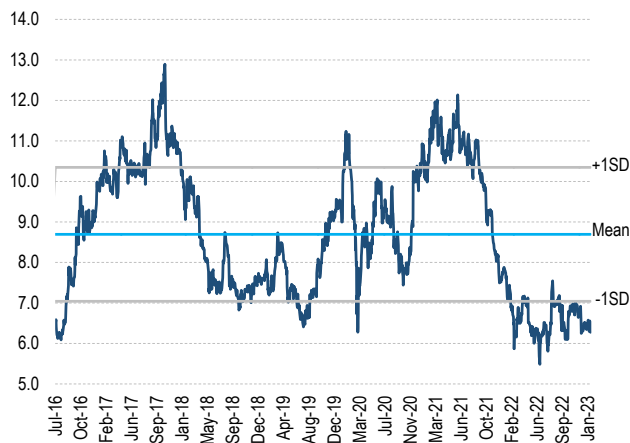
Source: Anand Rathi Research

Fig 19 – Target-price sensitivity

Volume growth %	Target (Rs / sh)						
	-0.6%	1.4%	3.4%	5.4%	7.4%	9.4%	
8.5	885	901	918	935	952	968	
9.0	934	951	969	987	1,004	1,022	
9.5	982	1,001	1,020	1,039	1,057	1,076	
10.0	1,031	1,051	1,071	1,090	1,110	1,130	
10.5	1,080	1,101	1,121	1,142	1,163	1,183	
11.0	1,129	1,151	1,172	1,194	1,216	1,237	

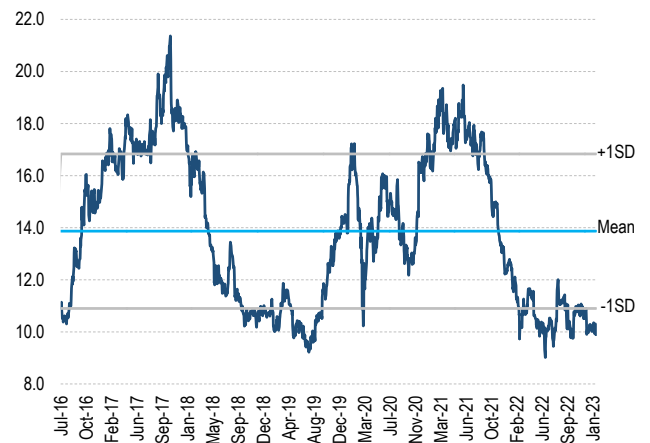
Source: Anand Rathi Research

Fig 20 – EV / EBITDA band, one-year-forward



Source: Bloomberg, Anand Rathi Research

Fig 21 – P/E band, one-year-forward



Source: Bloomberg, Anand Rathi Research

Risks

- Slower volume growth
- Margin compression on lower differences vs alternatives
- Regulatory changes, sharp increase in LNG prices
- Slower infrastructure rollout
- Competition from alternative fuels like electricity for vehicles

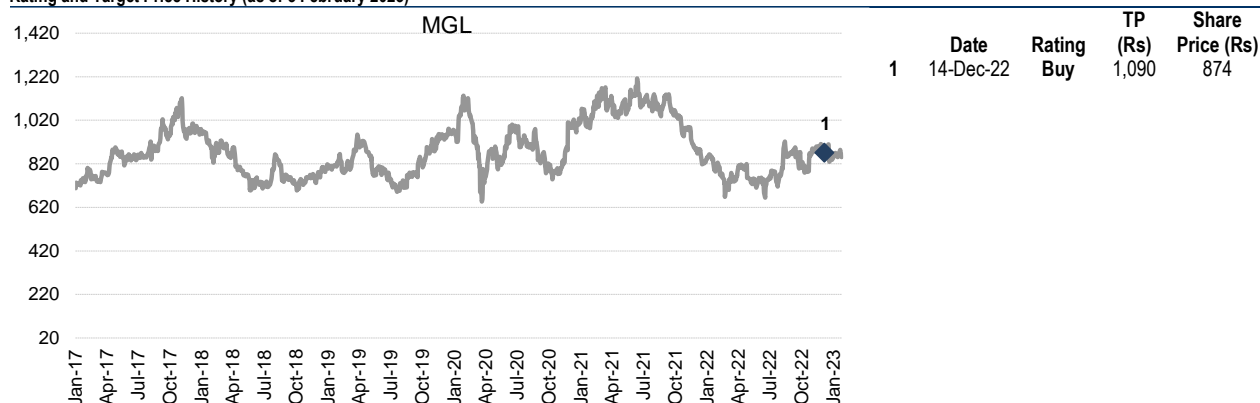
Appendix

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Rating and Target Price History (as of 3 February 2023)



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Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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