Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Event Update

Mahanagar Gas Ltd

UEPL acquisition a strategic fit and allay growth concerns

Oil & Gas	Sharekhan code: MGL
Reco/View: Buy ↔	CMP: **Rs. 986** | Price Target: **Rs. 1,100** ↑

↑ 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 Feb 08, 2023

High Risk

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

Source: Morningstar

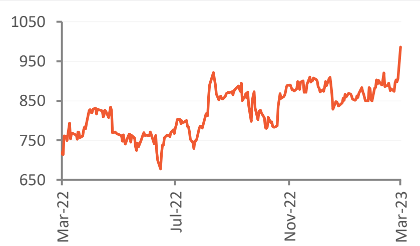
Company details

Market cap:	Rs. 9,743 cr
52-week high/low:	Rs. 990/666
NSE volume: (No of shares)	4.1 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	11.8	9.1	14.0	37.4
Relative to Sensex	12.3	13.3	12.3	26.6

Sharekhan Research, Bloomberg

Summary

- MGL to acquire a 100% stake in Unison Enviro Private Limited (UEPL) for Rs. 531 crore. UEPL is implementing CGD network in Ratnagiri, Latur & Osmanabad in Maharashtra and Chitradurga & Devengere in Karnataka.
- EV/sales of 6x and EV/BV of 6.4x is expensive compared to valuation of large listed CGDs players but is structurally important for MGL as it provides growth opportunities beyond Mumbai and expands its total GAs to six (versus three currently).
- Inorganic foray is expected to allay the concern of weak volume growth versus peers and sustained strong volume growth could drive valuation re-rating for MGL (cheapest CGD stock). Ratnagiri GA seems be a strategic fit for MGL, as it is adjoining to its Raigad GA, which could provide synergy benefit of faster ramp-up of Ratnagiri GA.
- We maintain our Buy on MGL with a revised PT of Rs. 1,100 (the increase reflects rollover of our PE multiple to FY2025E EPS), given inexpensive valuation of 10.7x its FY2025E EPS (at a discount of 29% to three-year average PE of 15x) and expectation of strong earnings recovery, given supportive government policies.

Mahanagar Gas Limited (MGL) announced the acquisition of 100% stake in UEPL (owned by Ashoka Buildcon and Morgan Stanley India Infra Fund) for Rs. 531 crore, subject to regulatory approvals. The deal valuation seems expensive at P/BV of 6.4x but is structurally positive for MGL, as it provides growth opportunities beyond Mumbai and is expected to allay historical concerns of low volume growth as compared to high volume growth for IGL. We maintain our Buy rating on MGL with a revised price target (PT) of Rs. 1,100.

- **MGL to acquire UEPL:** MGL announced to acquire a 100% stake in UEPL for Rs. 531 crore. UEPL is authorised by PNGRB to implement the city gas distribution (CGD) network in Ratnagiri, Latur & Osmanabad in Maharashtra and Chitradurga & Devengere in Karnataka. UEPL has 41 CNG stations, 8.8k D-PNG connections, and 38 I&C customers and reported revenue/net loss/net worth of Rs. 89 crore/Rs. 25 crore/Rs. 83 crore in FY2022.
- **Deal valuation is expensive, but it is structurally positive for MGL as it provides growth opportunities beyond Mumbai:** The deal valuation of EV/sales and EV/BV at 6x and 6.4x, respectively, seems expensive compared with the valuation of listed CGD companies (MGL trades at 2.6x FY2022 EV/sales and 2.7x FY2022 EV/BV, while IGL trades at 3.9x FY2022 EV/sales and 4.5x EV/BV). Although the acquisition seems expensive, UEPL is at an initial stage of building CGD infrastructure and with a gradual expansion of CNG stations, steel pipeline, and addition of new customers, which would drive long-term volume growth for the acquired GAs. Inorganic foray is structurally positive for MGL, as it provides growth opportunities beyond Mumbai and allays concerns of weak volume growth of MGL versus IGL and Gujarat Gas.
- **Strategic fit for MGL's Raigad GA:** We believe UEPL's acquisition is a strategic fit for MGL, given Ratnagiri GA of UEPL is adjoining to MGL's Raigad GA in Maharashtra. This provides a synergy benefit for expansion of the CGD network, scope for faster ramp-up of Ratnagiri GA, and growth opportunities beyond Mumbai.

Our Call

Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,100: 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 FY2024E-FY2025E. We expect MGL's PAT to report a 15% PAT CAGR over FY2022-FY2025E, along with healthy RoE/RoCE of 20%/25%. MGL is the cheapest CGD stock with an attractive valuation of 11.8x/10.7x its FY24E/FY25E EPS. Hence, we maintain our Buy rating on MGL with a revised PT of Rs. 1,100 (rollover of PE multiple to FY2025E EPS).

Key Risks

Lower-than-expected gas sales volume in case of slowdown and lower CNG conversions. Any 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	5,841	6,191
OPM (%)	26.0	16.0	21.0	21.7
Adjusted PAT	597	665	826	911
% YoY growth	-3.7	11.4	24.3	10.2
Adjusted EPS (Rs.)	60.4	67.3	83.7	92.2
P/E (x)	16.3	14.6	11.8	10.7
P/B (x)	2.7	2.5	2.2	2.0
EV/EBITDA (x)	10.0	8.0	6.6	5.7
RoNW (%)	17.5	17.6	19.9	19.8
RoCE (%)	22.1	22.2	25.1	25.1

Source: Company; Sharekhan estimates

MGL announces to acquire UEPL for Rs. 531 crore – Inorganic foray is structurally positive

MGL has announced to acquire 100% stake in UEPL for Rs. 531 crore subject to regulatory approvals. UEPL is owned by Ashoka Buildcon and Morgan Stanley India Infra Fund. UEPL is authorised by PNGRB to implement the CGD network in Ratnagiri, Latur, and Osmanabad in Maharashtra, and Chitradurga and Devengere in Karnataka.

Deal valuation seems expensive at P/BV of 6.4x but is a strategic fit for MGL

The deal valuation of EV/sales and EV/BV at 6x and 6.4x, respectively, seems expensive compared with the valuation of listed CGD companies (MGL trades at 2.5x FY2022 EV/sales and 2.6x FY2022 EV/BV, while IGL trades at 3.9x FY2022 EV/sales and 4.5x EV/BV). Although the acquisition seems expensive, UEPL is at an initial stage of building CGD infrastructure; and with gradual expansion of CNG stations, the steel pipeline network and addition of new customers would drive long-term volume growth for the acquired GAs. Inorganic foray is structurally positive for MGL as it provides growth opportunities beyond Mumbai and allays concerns of weak volume growth of MGL versus IGL and Gujarat Gas. We believe UEPL's acquisition is a strategic fit for MGL, given Ratnagiri GA of UEPL is adjoining to MGL's Raigad GA in Maharashtra. This provides synergy benefits for expansion of the CGD network, scope for faster ramp-up of Ratnagiri GA, and growth opportunities beyond Mumbai.

Key financials and CGD network of UEPL

Particulars	FY2022
Revenue (Rs. crore)	89
Net loss (Rs. crore)	25
Net worth (Rs crore)	83
CNG stations (nos.)	41
D-PNG connections (nos.)	8800
I&C customers (nos.)	38
Deal valuation	
Implied FY2022 EV/sales (x)	5.9
Implied FY2022 EV/BV (x)	6.4

Source: MGL; UEPL; Sharekhan Research

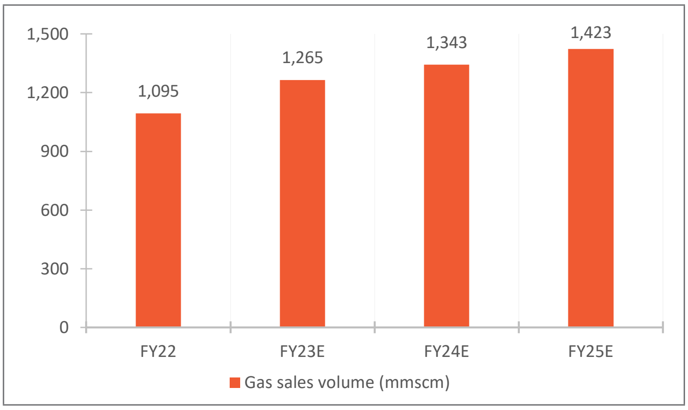
Details of three GAs to be acquired by MGL

Particulars	Ratnagiri (Maharashtra)	Latur & Osmanabad (Maharashtra)	Chitradurga and Davanagere (Karnataka)
Grant of authorisation (year)	August-16	August-18	August-18
Area (sq. km)	8276	14726	14360
MWP			
CNG stations	**NA**	**30**	**42**
Inch pipeline (km)	1800	10	75
D-PNG connections	19856	9999	101000

Source: PNGRB; Sharekhan Research

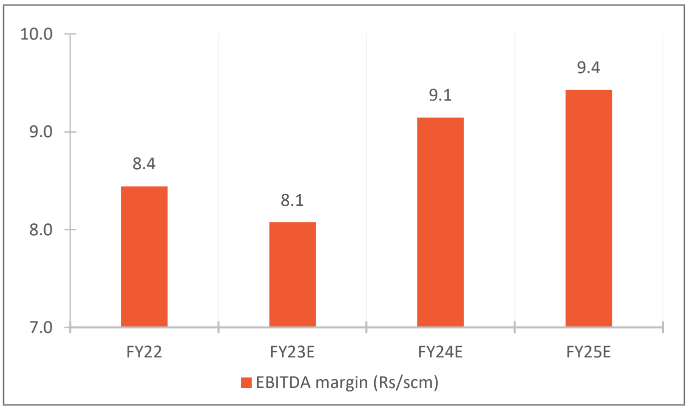
Financials in charts

Healthy volume growth over FY2023E-FY2025E



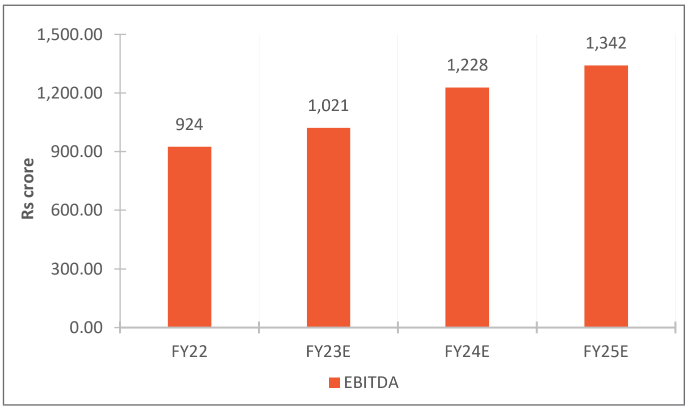
Source: Company, Sharekhan Research

Margin to recover led by APM gas price cap



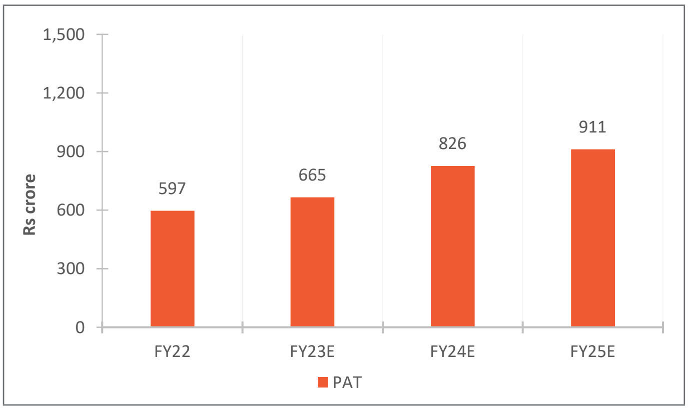
Source: Company, Sharekhan Research

EBITDA to post a 13% CAGR over FY2022-FY2025E



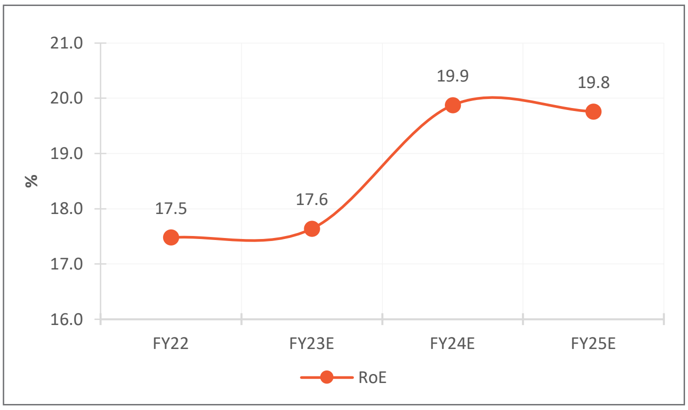
Source: Company, Sharekhan Research

PAT to post a 15% CAGR over FY2022-FY2025E



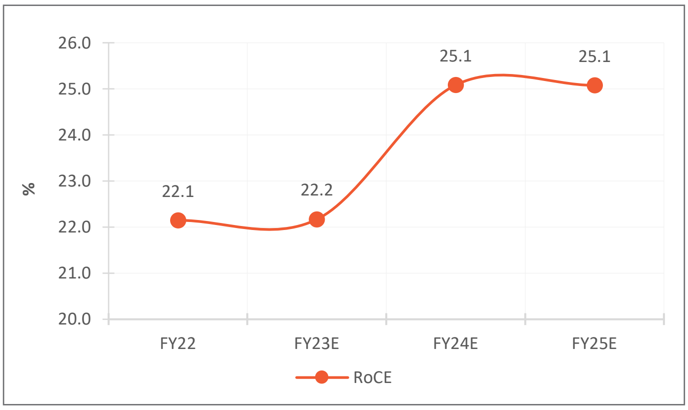
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



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 the domestic gas price at $6.5/mmbtu (versus $8.6/mmbtu for H2FY2023) could remove gas cost overhang for CGDs in FY2024. Further, a potential normalisation of international gas price from FY2025 would mean APM gas price could remain in the range of $4-6.5/mmbtu. This would improve volume growth visibility (supported by the 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 either through HP-HT gas or expensive spot LNG as a likely increase in APM gas allocation would be a difficult task. Moreover, a gradual shift towards EVs could impact CNG volume growth potential in the long term.

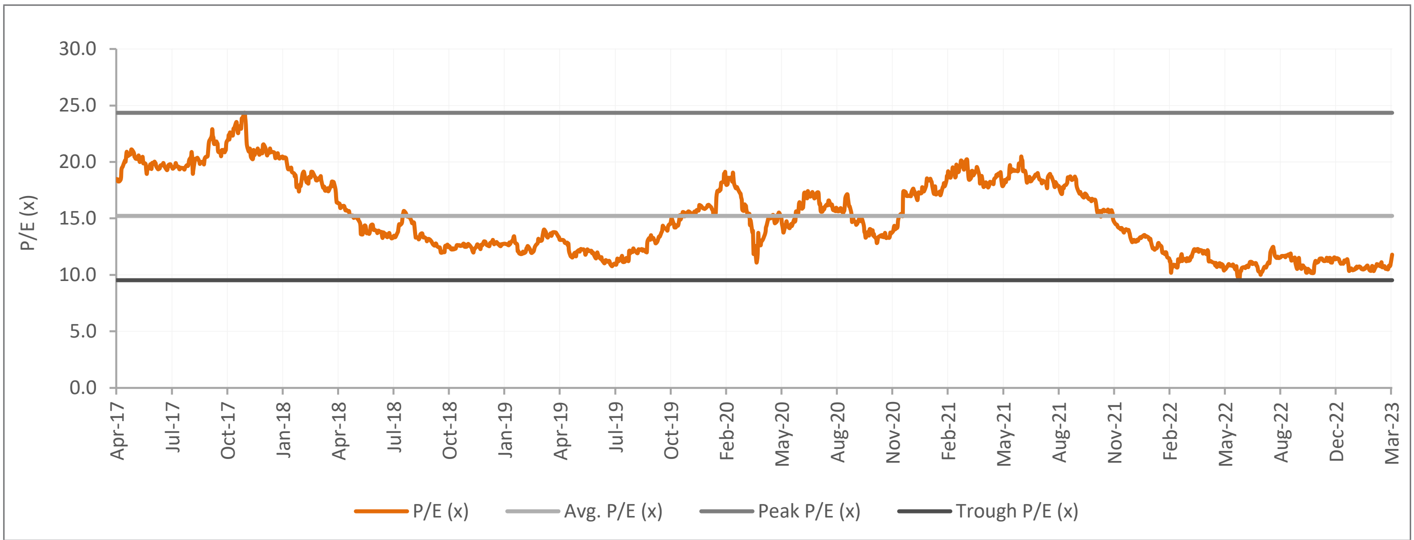
■ Company Outlook – Volume and margin recovery to drive decent earnings growth

Setting up of a 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 FY2024E for the priority sector of CNG/D-PNG. Thus, we expect margin recovery to be Rs. 9.1/Rs. 9.4 per scm in FY2024E/FY2025E as compared with our estimate of Rs. 8.1/scm (a 4% y-o-y decline) in FY2023. Double-digit volume growth and margin recovery would drive a 13%/15% EBITDA/PAT CAGR over FY2022-FY2025E.

■ Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,100

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 FY2024E-FY2025E. We expect MGL's PAT to report a 15% PAT CAGR over FY2022-FY2025E, along with healthy RoE/RoCE of 20%/25%. MGL is the cheapest CGD stock with an attractive valuation of 11.8x/10.7x its FY24E/FY25E EPS. Hence, we maintain our Buy rating on MGL with a revised PT of Rs. 1,100 (rollover of PE multiple to FY2025E EPS).

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 the high gas cost overhang for CGDs and drive volume/margin recovery over FY2024-FY2025. MGL is the cheapest CGD stock.

Key Risks

- Lower-than-expected gas sales volume in case of slowdown and lower CNG conversions.
- Any 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	10.00
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	3.70
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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.