



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

Updated Mar 08, 2023

34.43

High Risk

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

Source: Morningstar

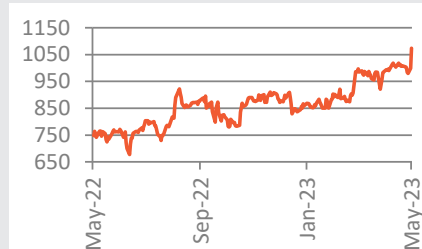
Company details

Market cap:	Rs. 10,611 cr
52-week high/low:	Rs. 1,098/666
NSE volume: (No of shares)	4.8 lakh
BSE code:	539957
NSE code:	MGL
Free float: (No of shares)	6.7 cr

Shareholding (%)

Promoters	32.5
FII	31.0
DII	14.9
Others	21.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.1	19.1	22.4	43.6
Relative to Sensex	4.9	17.3	20.5	30.0

Sharekhan Research, Bloomberg

Mahanagar Gas Ltd

Record margins power Q4; low gas cost brightens outlook

Oil & Gas	Sharekhan code: MGL		
Reco/View: Buy	↔	CMP: Rs. 1,074	Price Target: Rs. 1,285
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Q4FY23 PAT of Rs. 269 crore (up 56% q-o-q) was significantly above our estimate led by large beat in EBITDA margin at Rs. 12.8/scm (up 57% q-o-q) on lower gas costs, which offset a marginal miss in gas sales volume at 3.4 mmcsmd (down 1.2% q-o-q)
- Surge in EBITDA margin was driven by replacement of expensive spot LNG with HP-HT gas and steep decline in spot LNG prices to \$17/mmBtu (versus \$33/mmBtu in Q3FY23). CNG volumes declined by 2.6% q-o-q to 2.4 mmcsmd while D-PNG/I&C volume grew by 2.4%/2.9% q-o-q to 0.51/0.49 mmcsmd.
- The management maintained its 5-6% volume CAGR guidance for next few years but expects upside as recent cut in CNG price (post capping of APM gas price at \$6.5/mmBtu) would improve CNG conversions going forward. Gas costs now seem in comfortable position and the management expects to sustain current margin for a quarter. We have increased our FY24-FY25 earnings estimate by 11-12% to factor higher margin assumption.
- Despite a sharp 27% rise in stock price in CY23YTD, valuation of 10.5x its FY25E EPS is attractive given steep discount to peers as well as to MGL's historical PE. We see scope for valuation re-rating as recent acquisition of Unison Enviro could allay low volume growth concerns for MGL. Hence, we maintain a Buy on MGL with an increased PT of Rs. 1,285.

Mahanagar Gas Limited's (MGL) Q4FY23 numbers were robust with a beat of 54%/67% in operating profit/PAT at Rs. 390 crore/Rs. 269 crore, up 52%/56% q-o-q led by significantly better-than-expected EBITDA margin and higher other income offsetting lower gas sales volume. EBITDA margins surprised positively with a sharp increase of 57% q-o-q to Rs. 12.8/scm (59% above our estimate) as lower gas cost (down 13% q-o-q) led to strong gross margins of Rs. 18.7/scm (up 36% q-o-q and 37% above our estimate). The reduction in weightage average gas cost reflects sharp decline in spot LNG price to \$17/mmBtu (versus \$33/mmBtu in Q3FY23) as well as replacement of HP-HT gas (priced lower at \$12/mmBtu) with expensive spot LNG. We highlight here that MGL sourced 0.19 mmcsmd of HP-HT gas in Q4FY23 which is almost half of spot LNG sourcing of 0.36 mmcsmd in Q3FY23. The gas sales volume of 3.4 mmcsmd (down 1.2% q-o-q) was 3% below our estimate of 3.5 mmcsmd as CNG volumes declined by 2.6% q-o-q to 2.4 mmcsmd as high CNG price impacted demand and ~300 BEST buses were also off-road in Q4FY23. D-PNG/I&C volume grew by 2.4%/2.9% q-o-q to 0.51/0.49 mmcsmd.

Key positives

- A sharp 37%/59% beat in gross/EBITDA margin at Rs. 18.7/Rs. 12.8 per scm, up 36%/57% q-o-q led by lower gas cost.
- D-PNG/I&C PNG sales volumes grew by 2.4%/2.9% q-o-q to 0.51 mmcsmd/0.49 mmcsmd.

Key negatives

- CNG sales volume declined by 2.6% q-o-q to 2.4 mmcsmd.

Management Commentary

- Volume growth guidance maintained at 5-6% p.a. for the next few years with upside potential, given that CNG price cut by 9% to Rs. 79/kg could increase CNG conversions (MGL saw a 7% week-on-week volume growth post CNG price cut on April 08, 2023). Any regulatory support could further improve volume growth.
- Current EBITDA margin is sustainable for next few months or a quarter as gas cost remain in comfortable situation given replacement of expensive spot LNG with HP-HT gas and a steep decline in spot LNG price to \$10-12/mmBtu. MGL has fully passed on lower APM gas cost benefit to end customers and will look into further price cuts based on petrol prices.
- Gas sourcing allocation** – Gas requirement for CNG/D-PNG to be met through APM and HP-HT gas in FY24. Expect APM gas allocation at 88-90% (versus 93% in FY23).
- Unison Enviro Private Limited (UEPL) acquisition** – Management expects final approval from regulator by Oct/Nov'23. Current UEPL volume stand at 0.1 mmcsmd.
- Capex guidance** of Rs. 500-600 crore each for FY24/FY25 and compared to capex spending of Rs. 580 crore in FY23.
- Other updates** – 1) FY24 CNG station addition target of 40 (versus addition of 25 in FY23), 2) CNG conversion was lower ~13,000 in Q4FY23 versus 15,000-17,000 in Q3/Q4FY23, 3) MGL to set-up CBG plant along with BMC and a gas PSU

Revision in estimates – We have increased our FY24-25 earnings estimate to factor in higher margin assumption.

Our Call

Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,285: Supportive government policies to cap domestic gas prices 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 13% PAT CAGR over FY23-25E, along with healthy RoE/RoCE of 21%/26%. MGL is the cheapest CGD stock with attractive valuation of 11.5x/10.5x FY24E/FY25E EPS. Hence, we maintain a Buy rating on MGL with a revised PT of Rs. 1,285 (increase in PT reflects earnings upgrade and rollover of P/E multiple to FY25E EPS).

Key Risks

Lower-than-expected gas sales volume in case of slowdown and fewer 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	FY23	FY24E	FY25E
Revenue	3,560	6,299	5,757	6,103
OPM (%)	26.0	18.8	23.9	24.5
Adjusted PAT	597	790	924	1,015
% YoY growth	-3.7	32.3	17.0	9.8
Adjusted EPS (Rs.)	60.4	80.0	93.6	102.7
P/E (x)	17.8	13.4	11.5	10.5
P/B (x)	2.9	2.6	2.3	2.1
EV/EBITDA (x)	11.0	8.8	6.9	6.0
RoNW (%)	17.5	20.4	21.1	20.8
RoCE (%)	22.1	25.6	26.6	26.4

Source: Company; Sharekhan estimates

Robust Q4; best ever margin performance

Q4FY23 numbers were robust with a beat of 54%/67% in operating profit/PAT at Rs. 390 crore/Rs. 269 crore, up 52%/56% q-o-q led by significantly better-than-expected EBITDA margin and higher other income offsetting lower gas volumes. EBITDA margins surprised positively with a sharp increase of 57% q-o-q to Rs. 12.8/scm (59% above our estimate) as lower gas cost (down 13% q-o-q) led to strong gross margins of Rs. 18.7/scm (up 36% q-o-q and 37% above our estimate). The reduction in weightage average gas cost reflects sharp decline in spot LNG price to \$17/mmBtu (versus \$33/mmBtu in Q3FY23) as well as replacement of HP-HT gas (priced lower at \$12/mmBtu) with expensive spot LNG. We highlight here that MGL sourced 0.19 mmscmd of HP-HT gas in Q4FY23 which is almost half of spot LNG sourcing of 0.36 mmscmd in Q3FY23. The gas sales volume of 3.4 mmscmd (down 1.2% q-o-q) was 3% below our estimate of 3.5 mmscmd as CNG volumes declined by 2.6% q-o-q to 2.4 mmscmd as high CNG price impacted demand and ~300 BEST buses were also off-road in Q4FY23. D-PNG/I&C volume grew by 2.4%/2.9% q-o-q to 0.51/0.49 mmscmd.

Q4FY2023 conference call highlights

- ♦ **Volume and margin guidance:** The management maintained its guidance of volume CAGR of 5-6% over the next few years. The management hinted that volume growth could see an upside given the recent cut in CNG price while a likely regulatory push would further improve volume growth outlook for MGL. Management expect Q4FY23 margin to sustain for next few quarters given comfortable gas prices now.
- ♦ **Q4FY23 gas sourcing mix** – Entire gas requirement for CNG and D-PNG was met through APM gas and HP-HT gas. MGL sources 0.19 mmscmd of HP-HT gas in Q4FY23 and balance was through APM gas. For I&C segment – 0.14 mmscmd of gas requirement was sourced through spot LNG and remaining through contracted LNG.
- ♦ **Capex/CGD infrastructure** – The management has spent ~Rs. 580 crore in FY23 and guided for Rs. 500-600 crore annual capex for FY24/FY25. Domestic PNG customers stood at 2.17 million (addition of 92,274 households q-o-q), steel pipeline of 6,535 km (addition of 128 km q-o-q), 313 CNG stations (added 12 new CNG station in Q4FY2023), and I/C customers at 4,558 as on March 31, 2022. The Raigad GA has 28 operational CNG stations and have total pipeline length of 382 kms.
- ♦ **CNG conversion and volume break-up**– Total CNG vehicle conversions were lower at 13,000 in Q4FY23 as compared to 16,900/ 15,500 in Q3FY23/Q2FY23. **CNG volume break-up** – Private cars/taxi aggregate combine volume share at 45%, auto rickshaws at 35%, buses at 8% and remaining from LCVs/trucks. CNG penetration is very low for commercial goods vehicle segment at only 2-3% and thus provide opportunity for growth.

Results

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	Rs cr QoQ (%)
Revenue	1,610	1,087	48.2	1,671	-3.6
Total Expenditure	1,221	871	40.1	1,415	-13.7
Operating profit	390	215	80.9	256	52.2
Other Income	34	23	48.2	32	4.3
Interest	2	2	-2.6	2	-8.7
Depreciation	64	56	15.0	59	9.1
PBT	357	180	98.1	227	57.1
Tax	88	49	82.1	55	59.9
Reported PAT	269	132	104.0	172	56.2
PAT	269	132	104.0	172	56.2
Equity Cap (cr)	10	10		10	
EPS (Rs.)	27.2	13.3	104.0	17.4	56.2
Margins (%)			BPS		BPS
OPM	24.2	19.8	437.1	15.3	887.5
NPM	16.7	12.1	456.4	10.3	639.6
Tax rate	24.8	26.9	-217.0	24.3	43.5

Source: Company, Sharekhan Research

Key operating performance

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Volume (mmscmd)	3.4	3.2	6.4	3.4	-1.2
Gross margin (Rs. /scm)	18.7	13.3	40.6	13.7	36.3
EBITDA margin (Rs. /scm)	12.8	7.6	70.0	8.2	57.4
CNG volume (mmscmd)	2.4	2.3	5.8	2.5	-2.6
Domestic PNG volume (mmscmd)	0.51	0.5	7.7	0.5	2.4
I/C PNG volume (mmscmd)	0.45	0.4	7.9	0.4	2.9

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) has removed gas cost overhang for CGDs. Further, a potential normalisation of international gas price from FY25 would mean APM gas prices could remain in a comfortable range. 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 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 rise in APM gas allocation would be difficult task. Moreover, a gradual shift towards EVs could affect CNG volume growth potential in the long term.

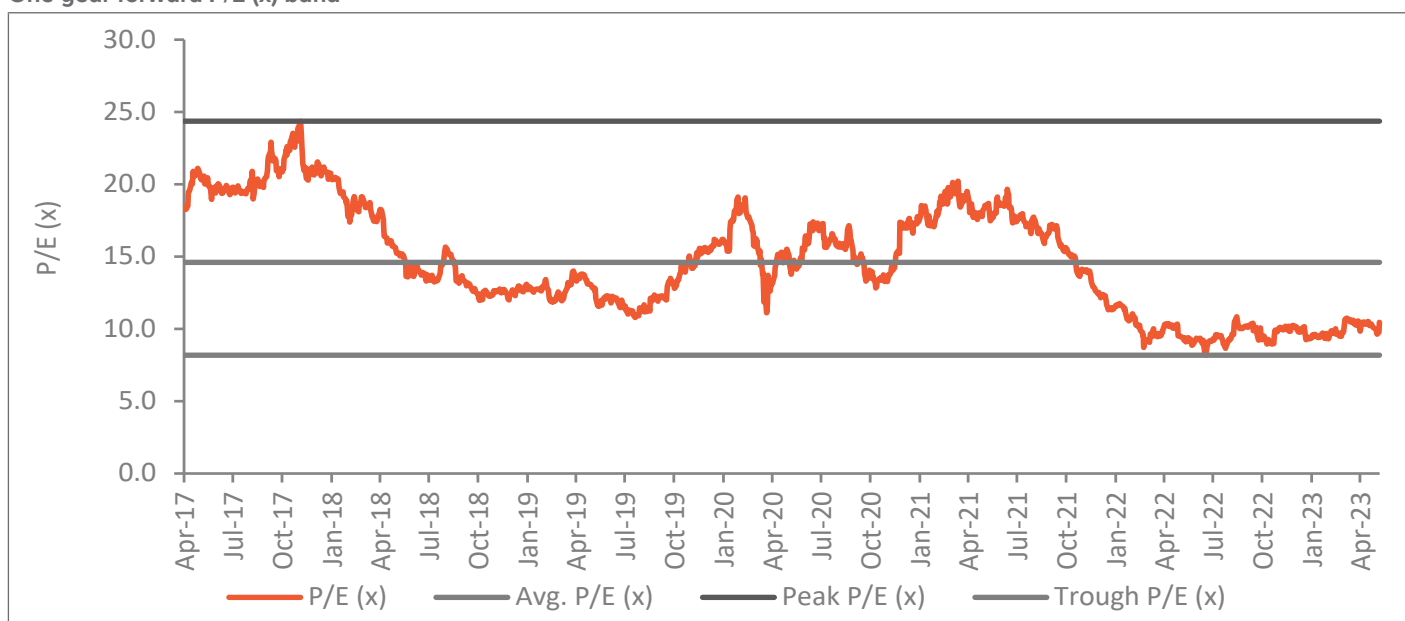
■ Company Outlook – Volume and margin recovery to drive decent earnings growth:

Setting-up of new CNG station in existing Mumbai GA and ramp-up at Raigad GA would drive a 6% volume CAGR over FY2023-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. 10.4/Rs. 10.6 per scm in FY24E/FY25E as Rs. 9.5/scm in FY23. Healthy volume growth and margin recovery would drive 12%/13% EBITDA/PAT CAGR over FY23-25E.

■ Valuation – Maintain Buy on MGL with a revised PT of Rs. 1,285

Supportive government policies to cap domestic gas prices 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 13% PAT CAGR over FY23-25E, along with healthy RoE/RoCE of 21%/26%. MGL is the cheapest CGD stock with attractive valuation of 11.5x/10.5x FY24E/FY25E EPS. Hence, we maintain a Buy rating on MGL with a revised PT of Rs. 1,285 (increase in PT reflects earnings upgrade and rollover of P/E multiple to FY25E EPS).

One-year forward P/E (x) band



Source: Sharekhan Research

About the company

MGL is a dominant CGD player in and around Mumbai with CNG/PNG sales volumes of 3.4 mmscmd currently. MGL derives 71% 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 313 CNG stations, 2.17 million PNG customers, and a pipeline network of 6,535 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 (0.5-0.6 mmscmd volume potential) would further add to the company's volume growth prospects. Recent capping of APM gas price at \$6.5/mmBtu would remove high gas cost overhang for CGDs and drive volume/margin recovery over FY24-25. Moreover, recent acquisition of Unison Enviro is expected to allay the concern of weak volume growth versus peers. 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: BSE, Company website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	State of Maharashtra	10.0
2	Life Insurance Corp of India	8.3
3	FMR LLC	6.3
4	Vontobel Holding AG	5.1
5	Schroders PLC	3.8
6	Fidelity Investment Trust	3.7
7	Vanguard Group Inc/The	2.2
8	Norges Bank	2.1
9	GOVERNMENT PENSI	1.9
10	ABERDEEN STANDARD OEIC II	1.4

Source: Bloomberg

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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 deteriorating 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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