Sharekhan
by BNP PARIBAS

# Petronet LNG

## Buoyant volume outlook on rising LNG demand

**Sector: Oil & Gas**
**Company Update**

| | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 246** | |
| Price Target: **Rs. 270** | ↔ |

↑ Upgrade ↔ No change ↓ Downgrade

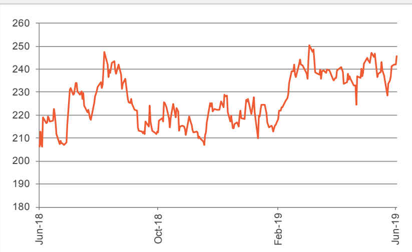
**Company details**

| | |
|---|---|
| Market cap: | Rs. 36,863 cr |
| 52-week high/low: | Rs. 255/203 |
| NSE volume: (No of shares) | 27.2 lakh |
| BSE code: | 532522 |
| NSE code: | PETRONET |
| Sharekhan code: | PETRONET |
| Free float: (No of shares) | 75.0 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 50.0 |
| FII | 25.7 |
| DII | 11.0 |
| Others | 13.3 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 0.0 | 1.4 | 8.6 | 22.7 |
| Relative to Sensex | -0.3 | -3.2 | -2.9 | 9.0 |

*Sharekhan Research, Bloomberg*

**Petronet LNG (PLNG) is set to report strong volume growth at an 8% CAGR over FY2019-FY2021E, supported by 1) recent completion of Dahej capacity expansion to 17.5 mmt; 2) strong demand appetite for low-cost liquefied natural gas (LNG, India's LNG imports grew by ~5.6% y-o-y in April-May 2019); and 3) likely improvement of utilisation at Kochi terminal post completion of Kochi-Mangalore pipeline infrastructure in southern India (expected by September/ October 2019, which is a delay of 3-4 months). Hence, we expect 11% earnings CAGR over FY2019-FY2021E along with robust RoE of 24-26%. In the absence of significant capex, the stock could offer healthy dividend yield of 4-5%. Hence, we maintain our Buy rating on PLNG with an unchanged price target (PT) of Rs. 270.**

### Volume growth triggers in place

We believe PLNG's Dahej capacity expansion to 17.5 mmt has come at the right time and the terminal could witness strong volume growth backed by: 1) sharp rebound in India's LNG imports (up 5.6% y-o-y during April-May 2019 vs. 11% y-o-y decline in Q4FY2019); 2) shutdown of Dabhol LNG terminal during monsoons due to breakwater issues; and 3) strong demand appetite for low-cost imported LNG. Additionally, higher volume offtake by a fertiliser customer and completion of Kochi-Mangalore pipeline section by September/October 2019 (delay by 3-4 months as per management's guidance) could ramp-up utilisation rate for Kochi terminal to 15%/30% in FY2020E/FY2021E. Thus, we expect PLNG's PAT to report an 11% CAGR, primarily led by volume growth.

### Our Call

**Valuation - Maintain Buy with unchanged PT of Rs. 270:** PLNG has superior RoE of 24-26%, 5.2% FCF field in FY2020E, de-risked business model and earnings growth visibility. Hence, we believe PLNG deserves a valuation premium compared with regulated utility companies. In our view, PLNG is trading at an attractive valuation of 13.1x its FY2021E EPS. Therefore, we maintain our Buy rating on the stock with an unchanged PT of Rs. 270. Moreover, in the absence of any significant capex in FY2020E, PLNG may surprise with dividend payout similar to FY2019 level of 70% and, thus, could result in healthy dividend yield of 4-5%.

### Key Risks

Delay in ramp-up of recently commissioned expansion at Dahej terminal to 17.5mmt and lower-than-expected Kochi utilisation rate.

**Valuation (Standalone)** Rs cr

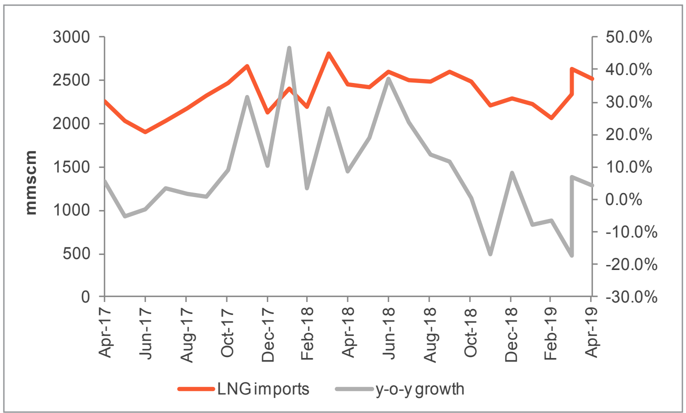
| Particulars | FY17 | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|---|
| Revenue | 24,616 | 30,599 | 38,395 | 46,307 | 51,399 |
| OPM (%) | 10.5 | 10.8 | 8.9 | 8.5 | 8.5 |
| Adjusted PAT | 1,706 | 2,078 | 2,291 | 2,514 | 2,810 |
| *% YoY growth* | *86.8* | *21.8* | *10.3* | *9.7* | *11.7* |
| Adjusted EPS (Rs) | 11.4 | 13.9 | 15.3 | 16.8 | 18.7 |
| P/E (x) | 21.6 | 17.7 | 16.1 | 14.7 | 13.1 |
| P/B (x) | 4.6 | 3.8 | 3.7 | 3.5 | 3.4 |
| EV/EBITDA (x) | 13.6 | 9.9 | 9.7 | 8.4 | 7.6 |
| RoNW (%) | 23.2 | 23.3 | 23.2 | 24.5 | 26.2 |
| RoCE (%) | 22.8 | 26.3 | 27.3 | 29.9 | 32.2 |

*Source: Company Data; Sharekhan estimates*

**Rebound in LNG imports and shutdown of Dabhol LNG terminal during monsoons to improve PLNG's Dahej utilisation in H1FY2020**

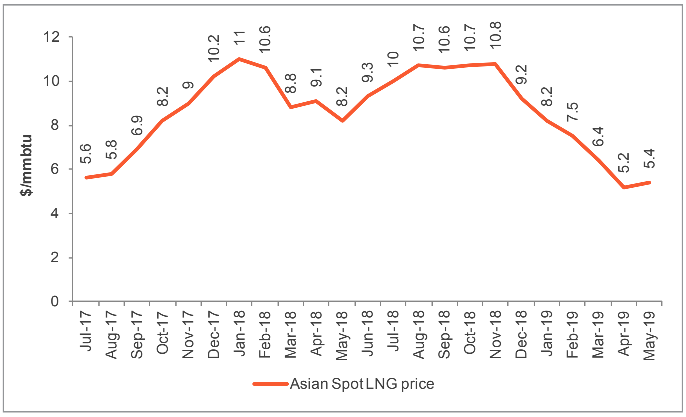
India's LNG imports recovered sharply to 2,522 mmscm (up 4.4% y-o-y) in May 2019 and to 2,630 mmscm (up 6.8% y-o-y) in April 2019 after posting an 11% y-o-y decline in Q4FY2019. Recovery in LNG demand can be attributed to the sharp decline in spot LNG prices to $5.2-5.4/mmbtu in April-May 2019 (vs. recent peak of $9-10/mmbtu) due to LNG supply glut. We expect higher LNG import volumes to benefit PLNG, as it has recently commissioned 2.5 mmtpa capacity expansion at Dahej terminal and Dabhol LNG terminal remains closed during monsoons.

**Sharp recovery in India's LNG imports**




*Source: Petroleum Planning and Analysis Cell*

**Spot LNG prices corrected sharply to $5/mmbtu**




*Source: Bloomberg*

**Kochi-Mangalore pipeline section could be delayed to September/October 2019; Kochi utilisation expected at 15% in FY2020**

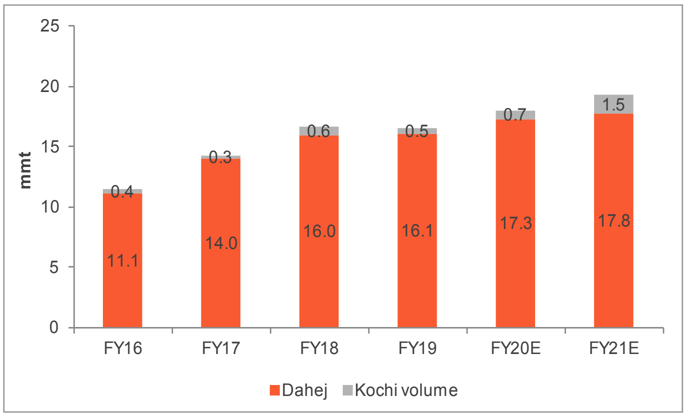
We spoke to the management of PLNG and the same has guided for 3-4 months delay in completion of Kochi-Mangalore pipeline section to September/October 2019 (vs. earlier guidance of June 2019). However, higher volume offtake from a fertiliser customer could result in slight improvement in the utilisation of Kochi terminal to ~15% in FY2020E (as compared to 10% in FY2019 and vs. our assumption of 14% utilisation in FY2020E). Post completion of Kochi-Mangalore pipeline section, the utilisation of Kochi terminal is expected to increase to 30% in FY2021E and would start contributing to profits of PLNG.

**Strong free cashflow and limited capex in the near term could result in high dividend payout**

PLNG plans to add a two-storage tank (estimated capex of ~$200 million) and jetty (estimates ~$160 million) at its Dahej terminal over the next three years, which would take capacity at Dahej terminal to 19.5 mtpa. Management has indicated that tendering for the award for contract for storage tanks and jetty would be done by mid-FY2020. Hence, we do not see any significant capital expenditure by PLNG in FY2020E and expect PLNG to generate free cashflow of ~Rs. 1,900 crore. Thus, in the absence of any significant capex for FY2020E (guidance of Rs. 600 crore), management could maintain higher dividend payout, resulting in higher dividend yield of 4-5%.

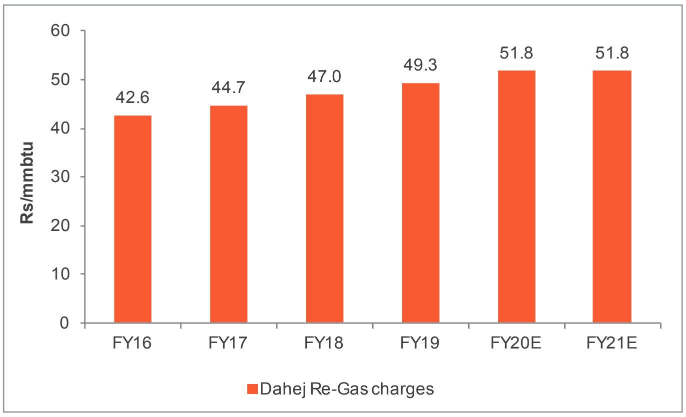
## Financials in charts

### Volume CAGR of 8% led by capacity expansion



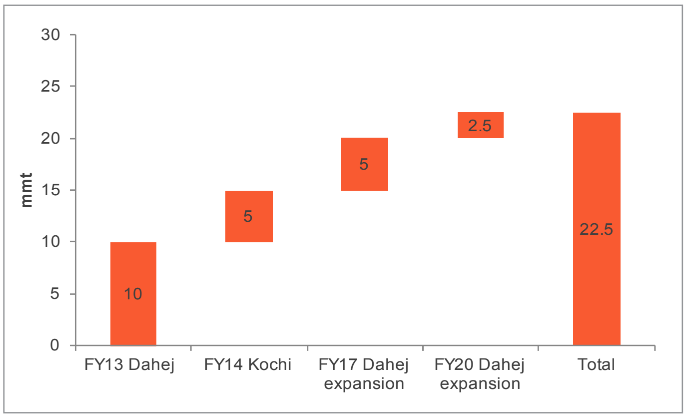

*Source: Company; Sharekhan Research*

### Consistent hike in Dahej re-gas charges



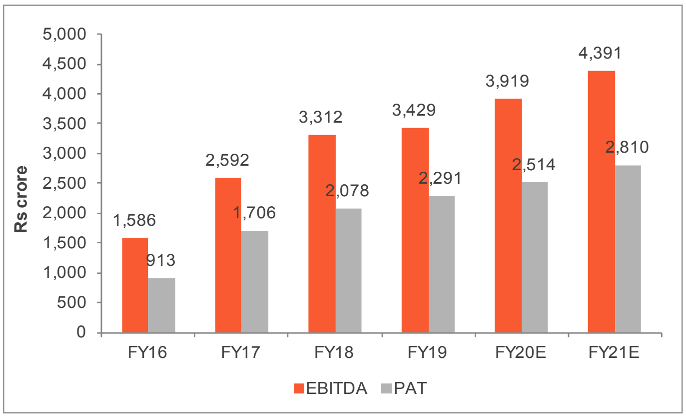

*Source: Company; Sharekhan Research*

### PLNG capacity expansion over FY13-FY20E



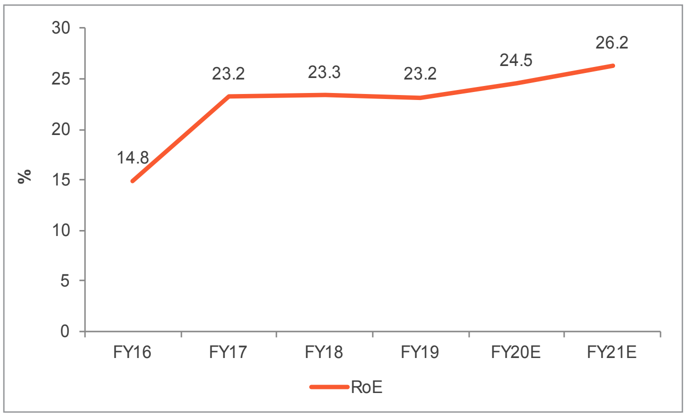

*Source: Company, Sharekhan Research*

### EBITDA/PAT to report 13%/11% CAGR over FY19-FY21E



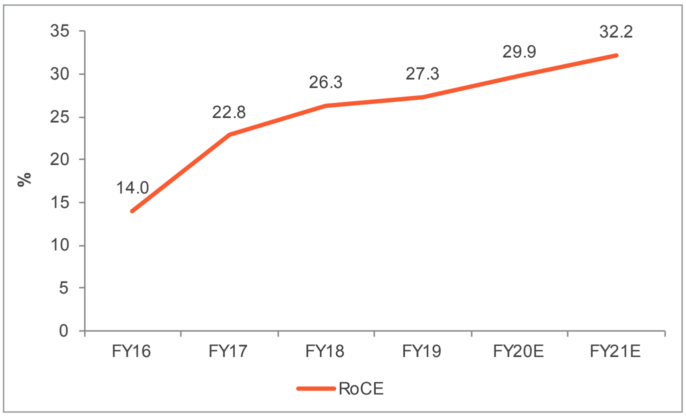

*Source: Company, Sharekhan Research*

### Strong RoEs driven by earnings growth




*Source: Company, Sharekhan Research*

### Consistent improvement in RoCE




*Source: Company, Sharekhan Research*

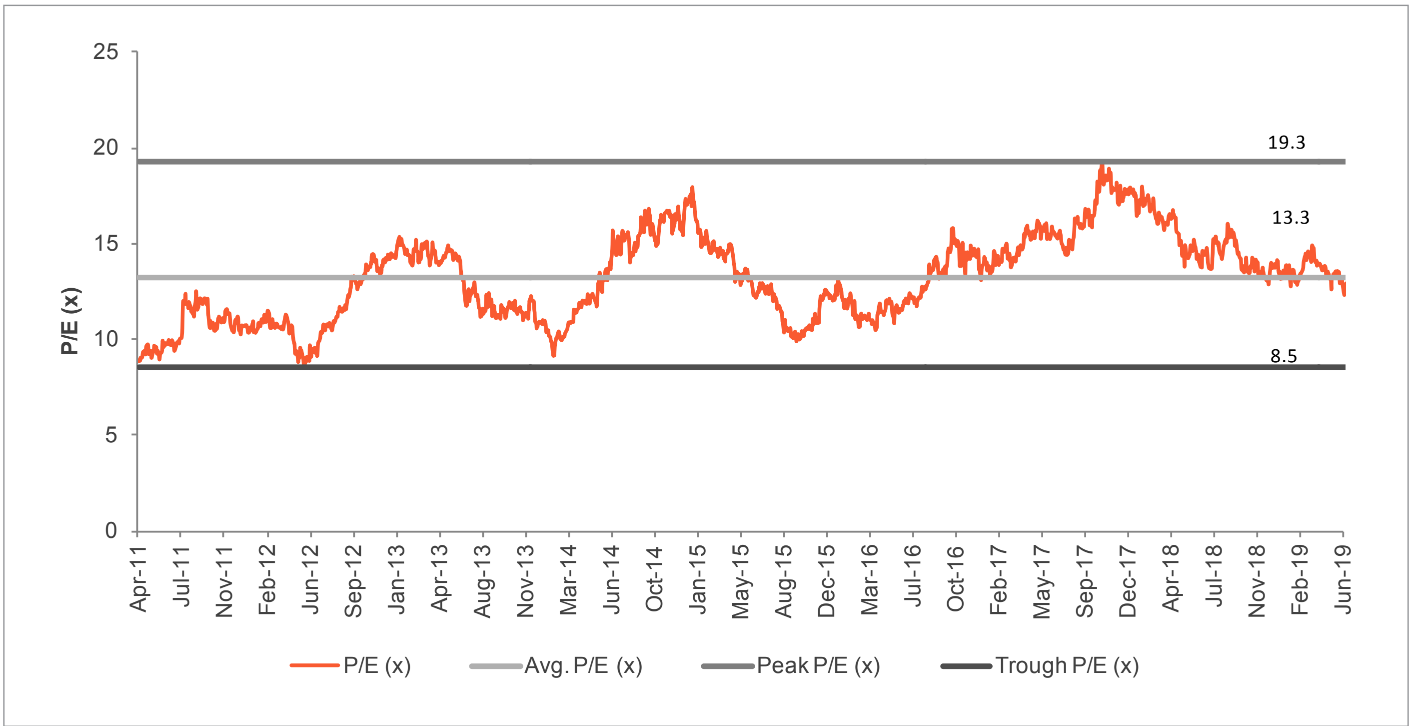
## Outlook - Expect 8% volume CAGR backed by Dahej expansion and Kochi ramp-up

The recent commissioning of Dahej expansion to 17.5 mmt and ramp-up of underutilised Kochi terminal post the completion of construction work on Kochi-Mangalore pipeline section by September/October 2019 (delay of 3-4 months) are key volume growth drivers for PLNG in FY2020E and FY2021E. We model an 8% volume CAGR over FY2019-FY2021E. Additionally, spot LNG prices hovering at $5-6/mmbtu could result into higher gas demand. Thus, PLNG could witness higher spot volume and could earn marketing margin as the company has excess capacity to handle post recent commissioning of expanded capacity at Dahej terminal.

## Valuation – Maintain Buy with an unchanged PT of Rs. 270

We believe PLNG deserves a valuation premium compared with the regulated utilities because of its superior RoE of 24-26%, 5.2% FCF field in FY2020E, de-risked business model and earnings growth visibility. In our view, PLNG is trading at an attractive valuation of 13.1x its FY2021E EPS. Hence, we maintain our Buy rating on the stock. Our price target remains unchanged at Rs. 270. Moreover, in the absence of any significant capex in FY2020E, PLNG may surprise with dividend payout similar to FY2019 level of 70%, leading to healthy dividend yield of 4-5%.

**One-year forward P/E (x) band**




*Source: Company; Sharekhan Research*

## About company

PLNG was incorporated in April 1998. PLNG imports, re-gasifies and markets LNG in India. The company owns and operates India's largest LNG terminal with capacity of 15 mmt at Dahej (Gujarat) and 5 mmt at Kochi (Kerala). The company has recently expanded its Dahej terminal to 17.5 mmt in June 2019 and plans to further increase the capacity to 19.5 mmt in the next 2-3 years. The company operates on a simple business model of charging re-gas margins on LNG volume imported (both long-term and spot) through its terminals. The company earns additional marketing margin on spot volumes marketed by it. The company's business is de-risked through back-to-back offtake contracts with customers.

## Investment theme

PLNG's growth would be primarily driven by an increase in its re-gas volumes supported by the recent expansion of its Dahej terminal capacity to 17.5 mmt and likely improvement in utilization rate of Kochi terminal (operating at 10-12% utilisation currently) with resolution of pipeline connectivity issues in southern India. Moreover, PLNG would be able to take 5% re-gas tariff escalation for its Dahej terminal on regular basis as it enjoys competitive edge compared to other LNG import terminals, given its low re-gas tariff and long-term contracted volume with use or pay clause.

## Key Risks

- A sharp rise in LNG prices could result in lower utilisation for PLNG's Dahej terminal.
- Delay in laying down of pipeline could keep Kochi terminal's utilisation rate low for an extended period.
- Non-revision of re-gas tariff on yearly basis.

## Additional Data

### Key management personnel

| Name | Designation |
|---|---|
| Prabhat Singh | Managing Director & CEO |
| Vinod Kumar Mishra | Director - Finance |
| Rajender Singh | Director - Technical |

*Source: Company*

### Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Indian Oil Corporation Limited | 12.5 |
| 2 | GAIL (India) Limited | 12.5 |
| 3 | Bharat Petroleum Corporation Limited | 12.5 |
| 4 | Oil and Natural Gas Corporation Limited | 12.5 |
| 5 | Kotak Mahindra Asset Management Company | 2.1 |
| 6 | BlackRock Inc | 2.0 |
| 7 | Franklin Resources Inc | 1.9 |
| 8 | FRANKLIN INDIA PENSION PLN | 1.5 |
| 9 | Aditya Birla Sun Life Trustee Company Private Limited | 1.5 |
| 10 | Aditya Birla Sun Life Asset Management Company Limited | 1.4 |

*Source: Bloomberg*

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