# Petronet LNG

## Improved business visibility, attractive valuation

| Oil & Gas | Sharekhan code: PETRONET | Company Update |
|---|---|---|

| 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 | | ↔ | |

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 248** | |
| Price Target: **Rs. 300** | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

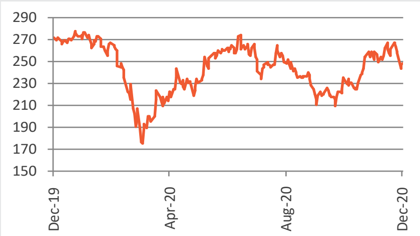
**Company details**

| | |
|---|---|
| Market cap: | Rs. 37,253 cr |
| 52-week high/low: | Rs. 280/171 |
| NSE volume: (No of shares) | 45.1 lakh |
| BSE code: | 532522 |
| NSE code: | PETRONET |
| Free float: (No of shares) | 75.0 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 50.0 |
| FII | 28.1 |
| DII | 8.4 |
| Others | 13.5 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -4 | 18 | -5 | -9 |
| Relative to Sensex | -8 | -9 | -39 | -21 |

*Sharekhan Research, Bloomberg*

**Summary**

- Sharp recovery in LNG imports (up 12% y-o-y in November and continuous y-o-y growth since July) would help Petronet LNG (PLNG) to sustain high utilisation rate for its Dahej terminal. PLNG to also take 5% re-gas tariff hike for Dahej terminal from January 2021.
- We do not see any concern on volume outlook from the recent rise in spot LNG price as 98% of volume comes from long-term and tolling contracts. Kochi terminal utilisation to reach breakeven level of 25% by Q4FY2021.
- PLNG is well positioned to tap India's rising LNG consumption with 2mmt expansion at Dahej terminal, ramp-up of Kochi terminal utilisation, and focus to enter LNG retailing business.
- We believe PLNG should command higher valuation multiple given earnings visibility (12% PAT CAGR over FY2021E-FY2023E) in uncertain times, high RoE of 29%, healthy FCF/ dividend yield of 8%/6%, and non-regulated business. Hence, we maintain our Buy on PLNG with an unchanged PT of Rs. 300.

**Sharp recovery in India's LNG import to 112% of pre-COVID-19 level in November and continuous y-o-y growth during July-November would help Petronet LNG (PLNG) to sustain high utilisation level at its Dahej LNG terminal in H2FY2021. Moreover, the recent sharp rise in spot LNG price and potential ramp-up in domestic gas production (expected at 30mmscmd -35mmscmd by FY2023) would not have any material impact on PLNG's re-gas volumes as ~98% volume is derived under long term and tolling contracts. In fact, rise in spot LNG price could result into inventory gain for PLNG in Q3FY2021 (we highlight here that the company had booked inventory loss of Rs. 31 crore in Q4FY2020). PLNG, being India's largest LNG importer (operates 50% of India's LNG capacity), is well placed to benefit from rising LNG consumption in India given its plans to further expand Dahej capacity 19.5 mmt in next 2-3 years, likely higher Kochi utilisation rate (expected to reach 25% by Q4FY2021) and focus to tap LNG retailing business. PLNG is one stock in the oil and gas space that provides high degree of earnings visibility (expect a 12% CAGR over FY2021E-FY2023E) along with high RoE/RoCE of 29% in the current uncertain times. Moreover, valuation of 10x FY2023E EPS seems attractive as it is at a steep 24% discount to its historical average one-year forward PE multiple of 13.2x. We believe PLNG should command higher valuation multiple given earnings visibility, high RoE, healthy FCF/dividend yield of 8%/6%, and non-regulated business model. Hence, we maintain our Buy rating on PLNG with an unchanged PT of Rs. 300.**

**Strong growth in India's LNG imports over July-November bodes well for sustained higher utilisation at Dahej LNG terminal:** India's LNG imports have recovered to 112% of pre-COVID-19 level with volumes of 2.2 million tonne in November 2020 post the sharp decline of 12.5% y-o-y in Q1FY2021. In fact, LNG volume has witnessed consistent y-o-y growth over July-November, which has negated the decline in volume in Q1FY2021. The sharp recovery in LNG imports (primarily driven by overall recovery in gas demand across sectors including power, CGD, refineries, and petchem) would help PLNG to sustain high utilisation rate (108% in Q2FY2021) for its Dahej terminal and the company would also implement 5% re-gas tariff hike for Dahej terminal with effect from January 2021. Moreover, capacity utilisation of Kochi terminal is expected to improve to 25% by Q4FY2021 as GAIL has completed the construction of Kochi-Mangalore pipeline. Overall, we believe PLNG is well placed to benefit from rising LNG demand with plans to further expand Dahej terminal capacity to 19.5mmt in the next 2-3 years.

**Our Call**

**Valuation - Maintain Buy on PLNG with an unchanged PT of Rs. 300:** Sharp volume recovery provides strong earnings visibility (expect a 12% earnings CAGR over FY2021E-FY2023E) during challenging times and PLNG's RoE/RoCE at ~29% is superior among gas utilities. Additionally, PLNG is believed to have backed out of its proposed deal with Tellurian, which removes the overhang of investment in overseas LNG assets (which is different from its current tolling business model). PLNG's valuation of 10x FY2023E EPS seems attractive as it is at a steep 24% discount to its historical average one-year forward PE multiple of 13.2x. We believe PLNG should command higher valuation given earnings visibility, high RoE, FCF/dividend yield of 8%/6%, and non-regulated business model. Hence, we maintain our Buy rating on PLNG with an unchanged PT of Rs. 300.

**Key Risks**

Lower-than-expected re-gas volumes at Dahej terminal in case of weak LNG demand amid COVID-19, and any further delay in ramp-up of utilisation rate at Kochi terminal due to pipeline connectivity issues.

**Valuation (Standalone)** Rs cr

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Revenue | 38,395 | 35,452 | 27,654 | 34,804 | 40,929 |
| OPM (%) | 8.9 | 11.3 | 16.9 | 15.2 | 14.0 |
| Adjusted PAT | 2,291 | 2,852 | 2,979 | 3,434 | 3,736 |
| % YoY growth | 10.3 | 24.5 | 4.4 | 15.3 | 8.8 |
| Adjusted EPS (Rs) | 15.3 | 19.0 | 19.9 | 22.9 | 24.9 |
| P/E (x) | 16.3 | 13.1 | 12.5 | 10.8 | 10.0 |
| P/B (x) | 3.7 | 3.4 | 3.2 | 3.1 | 2.6 |
| EV/EBITDA (x) | 9.8 | 8.2 | 6.7 | 5.8 | 5.0 |
| RoNW (%) | 23.2 | 27.1 | 26.5 | 29.1 | 28.0 |
| RoCE (%) | 27.3 | 24.9 | 25.9 | 28.5 | 28.3 |

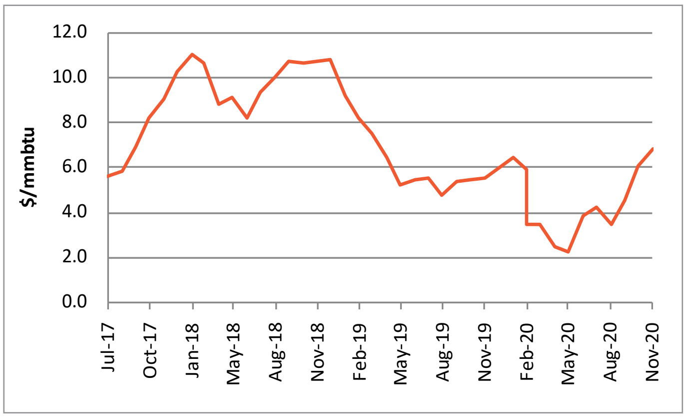
*Source: Company; Sharekhan estimates*

## LNG imports witness strong growth traction – bodes for well for sustained high utilization for PLNG's Dahej terminal

India's LNG imports have recovered to 112% of pre-COVID-19 level with volumes of 2.2 million tonne in November 2020 post the sharp decline of 12.5% y-o-y in Q1FY2021. In fact, LNG volumes have witnessed 16% y-o-y growth in October, 2% y-o-y in September, 5% y-o-y in August, and 6% y-o-y in July. With this, LNG imports are up marginally by 0.6% y-o-y to 16.6mmt during April-November 2020. The sharp recovery in LNG imports is primarily driven by overall recovery in gas demand across sectors, including power, CGD, refineries, and petchem. The rise in LNG imports bodes well for sustained high utilisation of Dahej terminal of PLNG.

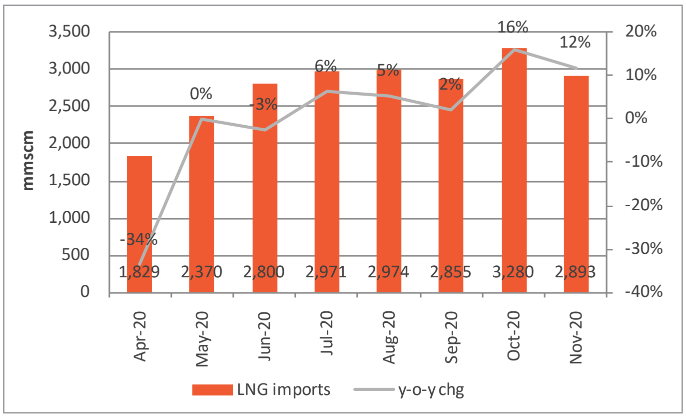
We have seen sharp recovery in the Asia spot LNG price to ~$7/mmBtu in November 2020 versus low of $2.2/mmBtu in May, but the rise in LNG price was driven by short-term supply issues from Australia (maintenance of Gorgon LNG project) and seasonal pick-up in LNG demand in winters. Thus, with normalisation of gas demand and resumption of LNG supply from Australia, we expect spot LNG price to revert to $3-4/mmBtu (which is affordable across user industries).

**Spot LNG price increases sharply due to temporary supply issues**




*Source: Bloomberg*

**India's LNG import grew by 12% y-o-y in November**




*Source: Petroleum Planning and Analysis Cell*

**Sectoral consumption of natural gas (October 2020)**

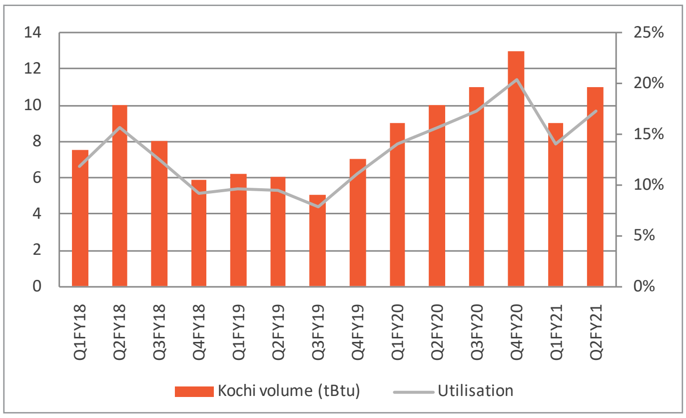
| Sectors (mmscm) | Domestic Gas | R-LNG | Total | Share of R-LNG |
|---|---|---|---|---|
| Fertiliser | 414 | 1141 | 1,555 | 73% |
| CGD | 462 | 417 | 879 | 47% |
| Power | 578 | 385 | 963 | 40% |
| Refinery | 83 | 593 | 676 | 88% |
| Petrochemical | 16 | 276 | 292 | 95% |
| Others | 222 | 390 | 612 | 64% |
| **Total** | **1,775** | **3,202** | **4,977** | **64%** |

*Source: Petroleum Planning and Analysis Cell*

## Kochi-Mangalore pipeline completed – To augment Kochi terminal utilisation rate to 25% by Q4FY2021

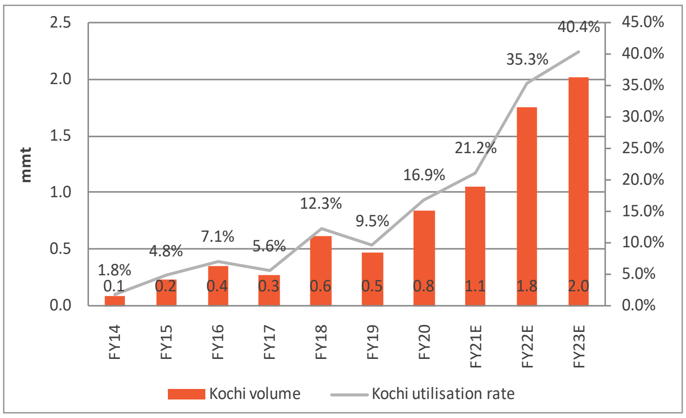
PLNG's 5mmt Kochi terminal is operating at 15%-17% capacity utilisation rate due to lack of pipeline connectivity in southern India. It has been incurring losses since the terminal was operationalised in FY2014. GAIL (India) has completed construction work on Kochi-Mangalore pipeline section and the pipeline is expected to gradually start ramp-up of gas transmission volume. With this, PLNG's management expects Kochi terminal utilisation to improve to 25% by Q4FY2021 versus 17% in Q2FY2021. The operational breakeven is at 25% utilisation for Kochi terminal. Moreover, GAIL is expected to start work on Kochi-Bangalore section of KKMBL pipeline and the same is expected to be completed in the next 2-3 years. Post the completion of Kochi-Bangalore section, utilisation of the Kochi terminal would further increase to 50%-60% in 2-3 years.

**Kochi terminal utilisation trend**




*Source: Company, Sharekhan Research*

**Kochi terminal utilisation to improve as pipeline issue gets resolved**



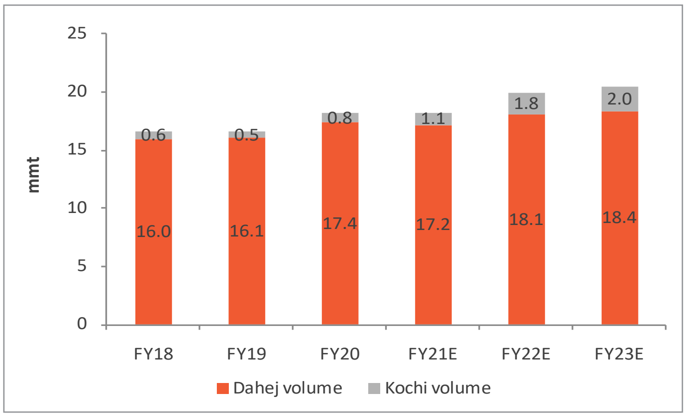

*Source: Company, Sharekhan Research*

### LNG dispensing infrastructure initiative in the right direction

Petroleum and Natural Gas Regulatory Board (PNGRB) in its notice has said that any company can set up LNG dispensing station in any geographical area (GA) even if it is not an authorised entity for that GA. PLNG has outlined phased development of LNG dispensing infrastructure (for long distance heavy duty trucks), where Phase 1 would comprise setting up of 50 LNG stations on five major highways (western and southern regions) during 2020-2021. Phase 2 would focus on ramp-up to 300 stations and Phase 3 to 1000 stations on pan-India basis. The company has signed MoU with a CGD player in Gujarat for setting up of five LNG dispensing stations on pilot basis (which would ramp up to 19 stations) and have plans to set-up eight LNG stations on Delhi-Mumbai highway. Overall, management sees 8 million tonne-9 million tonne volume opportunity over the medium to long term from LNG dispensing business and expects to earn reasonable margin given LNG is at a steep discount to diesel.

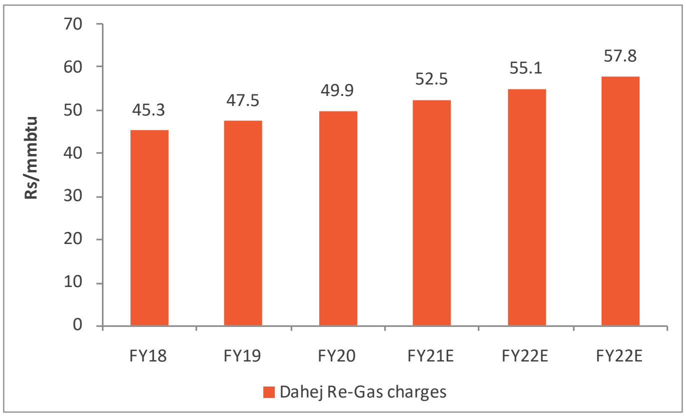
## Financials in charts

### Volumes to post a 6% CAGR over FY2021E-FY23E



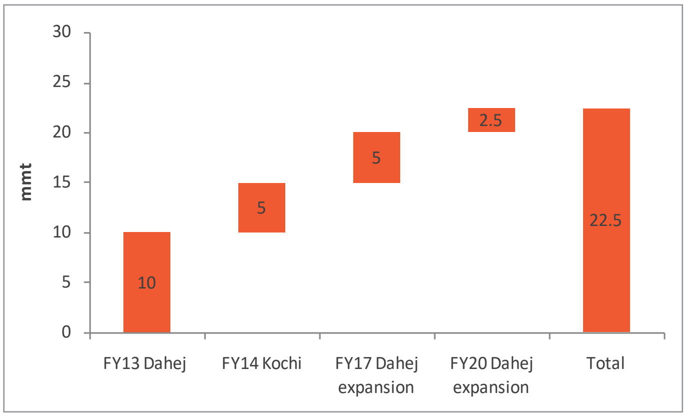

*Source: Company, Sharekhan Research*

### Consistent hike in Dahej re-gas charges



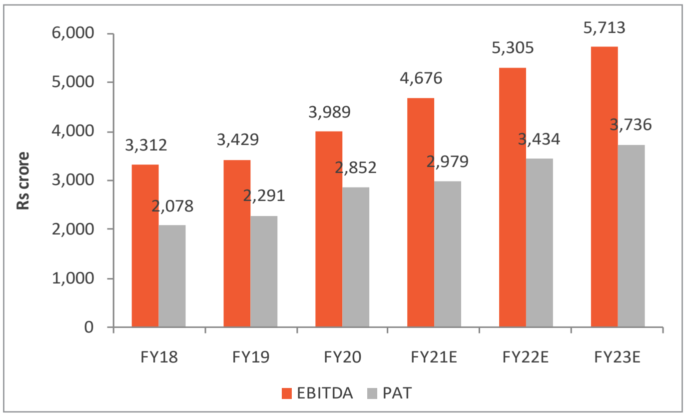

*Source: Company, Sharekhan Research*

### PLNG capacity expansion over FY2013-FY2020



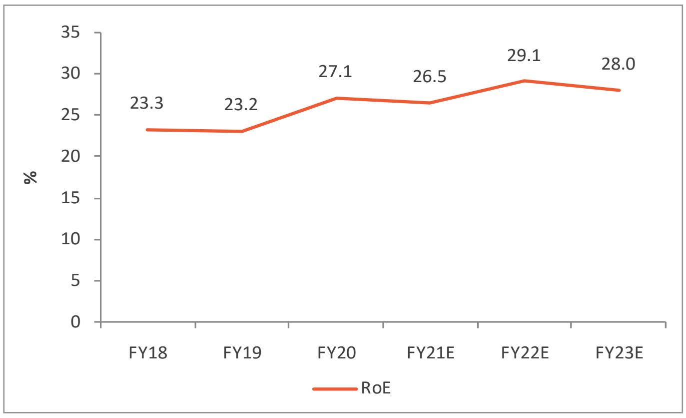

*Source: Company, Sharekhan Research*

### EBITDA/PAT to post 11%/12% CAGR over FY2021E-FY2023E



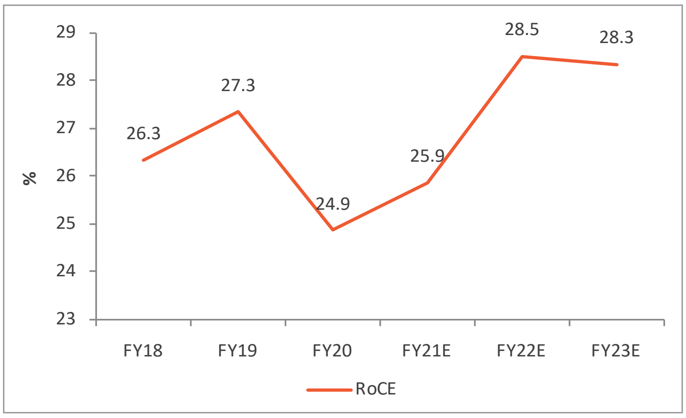

*Source: Company, Sharekhan Research*

### Strong RoEs driven by earnings growth




*Source: Company, Sharekhan Research*

### Consistent improvement in RoCE




*Source: Company, Sharekhan Research*

## Outlook and Valuation

### ■ Sector view - Regulatory push and affordable gas price to drive India's gas consumption

We expect strong volume growth to continue for gas utilities (such as PLNG) supported by robust gas demand outlook led by: 1) higher demand from power, CGD, and fertiliser sectors, 2) regulatory push to switch to gas from polluting industrial/auto fuels, 3) low domestic gas prices and affordable LNG prices and 4) government's aim to increase share of gas in India's overall energy mix to 15% by 2025. Hence, we believe long-term gas demand outlook for India remains intact and the same is expected to grow at 6%-7% annually over the next 5-10 years.

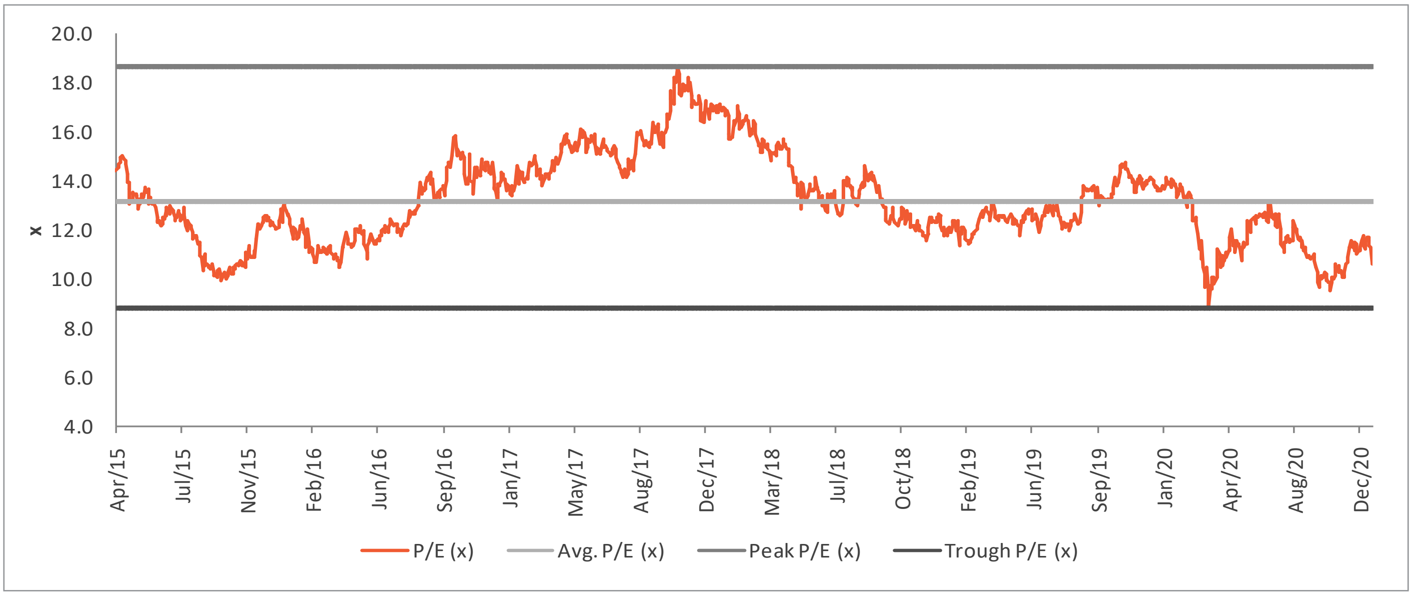
### ■ Company outlook - Sharp recovery in re-gas volume above pre-COVID-19 level provides earnings growth visibility

PLNG's Dahej terminal utilisation rate has recovered above pre-COVID-19 level, led by strong gas demand from the power sector and improving LNG demand from CGD and refineries. Moreover, PLNG, being India's largest LNG importer (operates 50% of India's LNG capacity), is well placed to benefit from rising LNG consumption in India. Moreover, GAIL (India) has completed the construction work at the Kochi-Mangalore pipeline section, which is expected to improve utilisation rate at PLNG's Kochi terminal to 21%/35% in FY2021E/FY2022E from ~17% currently. The company's competitive edge (lowest tariff in the industry) would also help it hike annual re-gas tariffs. Volume growth coupled with hike in re-gas tariff at Dahej terminal provides strong earnings growth visibility for PLNG.

### ■ Valuation - Maintain Buy on PLNG with unchanged PT of Rs. 300

Sharp volume recovery provides strong earnings visibility (expect a 12% earnings CAGR over FY2021E-FY2023E) during challenging times and PLNG's RoE/RoCE at ~29% is superior among gas utilities. Additionally, PLNG is believed to have backed out of its proposed deal with Tellurian, which removes the overhang of investment in overseas LNG assets (which is different from its current tolling business model). PLNG's valuation of 10x FY2023E EPS seems attractive as it is at a steep 24% discount to its historical average one-year forward PE multiple of 13.2x. We believe PLNG should command higher valuation given earnings visibility, high RoE, FCF/dividend yield of 8%/6%, and non-regulated business model. Hence, we maintain our Buy rating on PLNG with unchanged PT of Rs. 300.

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




*Source: Sharekhan Research*

## About company

PLNG was incorporated in April 1998. PLNG imports, re-gasifies, and markets liquefied natural gas (LNG) in India. The company owns and operates India's largest LNG terminal with a capacity of 17.5 mmt at Dahej (Gujarat) and 5 mmt at Kochi (Kerala). The company plans to further increase Dahej LNG terminal 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 margins on spot volumes. The company's business is de-risked through back-to-back offtake contracts with customers.

## Investment theme

The sharp recovery in re-gas volume at Dahej terminal provides earnings visibility in the current uncertain times. The company's plan to expand Dahej terminal's capacity to 19.5 mmt over the next 2-3 year and ramp-up of utilisation rate for Kochi terminal would drive volume growth. Moreover, PLNG would be able to take 5% re-gas tariff escalation for its Dahej terminal on a regular basis as it enjoys a competitive edge as compared to other LNG import terminals given its low re-gas tariff and long-term contracted volume with a 'use or pay' clause. PLNG's valuation is also attractive with strong RoE of 29%, FCF yield of 8%, and dividend yield of 6%.

## Key Risks

- Lower-than-expected re-gas volumes at the Dahej terminal in case of weak LNG demand amid COVID-19.
- Any further delay in the ramp-up of utilisation rate at the Kochi terminal due to pipeline connectivity issues.
- Non-revision of re-gas tariffs on a yearly basis.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Tarun Kapoor | Chairman |
| Vinod Kumar Mishra | Managing Director & CEO and Director (Finance) |
| Pramod Narang | Director – Technical |

*Source: Company website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | BlackRock Inc | 3.0 |
| 2 | FMR LLC | 2.9 |
| 3 | Kotak Mahindra Asset Management Company | 2.4 |
| 4 | Aditya Birla Sun Life Trustee Company | 1.4 |
| 5 | Vanguard Group Inc | 1.3 |
| 6 | GIC Pte Ltd | 1.2 |
| 7 | GOVERNMENT PENSION FUND - GLOBAL | 1.2 |
| 8 | Republic of Singapore | 1.1 |
| 9 | Norges Bank | 1.0 |
| 10 | Capital Group Cos Inc | 0.9 |

*Source: Bloomberg*

## 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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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