Sharekhan
by BNP PARIBAS

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Petronet LNG

Resilient Q3 performance; High degree of earnings visibility

Oil & Gas	Sharekhan code: PETRONET	Result 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. 242**	
Price Target: **Rs. 300**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

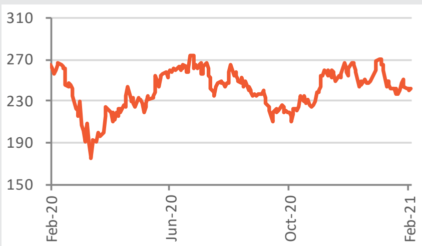
Company details

Market cap:	Rs. 36,315 cr
52-week high/low:	Rs. 280 / 171
NSE volume: (No of shares)	46.0 lakh
BSE code:	532522
NSE code:	PETRONET
Free float: (No of shares)	75.0 cr

Shareholding (%)

Promoters	50.0
FII	29.5
DII	7.0
Others	13.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9	-5	-9	-8
Relative to Sensex	-13	-23	-43	-33

Sharekhan Research, Bloomberg

Summary

- Robust Q3FY2021 results with 17% beat in operating profit at Rs. 1,335 crore, led by better cost management and inventory/trading gain of Rs. 60 crore/Rs. 54 crore on spot volumes.
- Kochi-Mangalore pipeline commissioned in November 2020, which would improve utilisation level of Kochi LNG terminal to 30% by Q3FY2022. Further ramp-up to 50%-60% likely with completion of Kochi-Bangalore pipeline section over the next 2-3 years.
- Notwithstanding slight moderation in Dahej utilisation in Q4FY2021, we believe PLNG is well positioned to tap India's rising LNG consumption with 5mmt expansion at Dahej terminal in two phases over the next 3-4 years. Focus on LNG fuel retailing and compressed biogas to aid in long-term volume growth.
- Valuation is attractive at 9.9x its FY2023E EPS, given earnings visibility, high RoE, and FCF/Dividend yield of 9%/6%. PLNG's non-regulated business model should command superior valuation. We maintain Buy on PLNG with an unchanged PT of Rs. 300.

Petronet LNG's (PLNG) Q3FY2021 operating profit stood at Rs1,335 crore (up 20.6% y-o-y; down 2% q-o-q), well above our estimate of Rs. 1,143 crore due to: 1) lower-than-expected operating cost with a sharp 15.7%/19.4% y-o-y decline in employee cost/other expenses; 2) inventory gain of Rs. 60 crore, given spike in spot LNG price; and 3) Rs. 54 crore for trading gain on spot volume. However, Dahej volumes at 222tbtu (flat y-o-y; down 8.6% q-o-q) were 2% lower than our estimate of 227tbtu due to lower tolling volumes at 104 tbtu (down 23% q-o-q), partially offset by higher long-term contracted re-gas volume at 113tbtu (up 9.7% q-o-q). Kochi terminal's volume stood at 13tbtu (up 18.2% y-o-y and q-o-q). Dahej utilisation rate stood at 99.5% (versus 99.5% in Q3FY2020 and 109% in Q2FY2021) and Kochi utilisation was at 20.4% (versus 17.3% in Q2FY2021). PAT (adjusted for IND AS-116 and Rs. 60 crore inventory gain) at Rs. 811 crore (up 20.2% y-o-y; down 5.9% q-o-q) was above our estimate of Rs. 765 crore due to a beat in operating profit. Notwithstanding slight moderation in Dahej utilisation in Q4FY2021 (lower offtake due to high spot LNG price), we believe PLNG (operates 50% of India's LNG capacity) would benefit from rising LNG consumption in India, supported by its plans to further expand Dahej capacity to 22.5 mmt (phase 1 to 19.5mmt and phase 2 to 22.5mmt from 17.5mmt currently) in the next 3-4 years and likely higher Kochi utilisation rate of 30% by Q3FY2022. Valuation of 9.9x its FY2023E EPS seems attractive (25% discount to its historical average one-year forward PE multiple of 13.2x), given high degree of earnings visibility and FCF/dividend yield of 9%/6%. Hence, we maintain our Buy rating on PLNG with an unchanged PT of Rs. 300.

Key positives

- Strong cost management led to 17% beat in operating profit.
- Kochi-Mangalore pipeline commissioned and would result in better Kochi terminal utilisation of 30% by Q3FY2022.

Key negatives

- Marginally lower Dahej utilisation at 99.5% versus expectation of 102%.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 300: We have fine-tuned our FY2021 earnings estimate as lower Dahej terminal utilisation assumption for Q4FY2021 gets offset by lower operating cost. We have marginally lowered our FY2022-FY2023 earnings estimates to factor lower utilisation for Kochi terminal. Sharp volume recovery provides strong earnings visibility (expect a 10% earnings CAGR over FY2021E-FY2023E) along with high RoE/RoCE at ~28% (superior among gas utilities). Moreover, PLNG's valuation of 9.9x its FY2023E EPS seems attractive as it is at a steep 25% 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 9%/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 any weakness in LNG demand amid COVID-19, spike in LNG price, and any further delay in the ramp-up of utilisation rate at Kochi terminal.

Valuation (Standalone) Rs cr

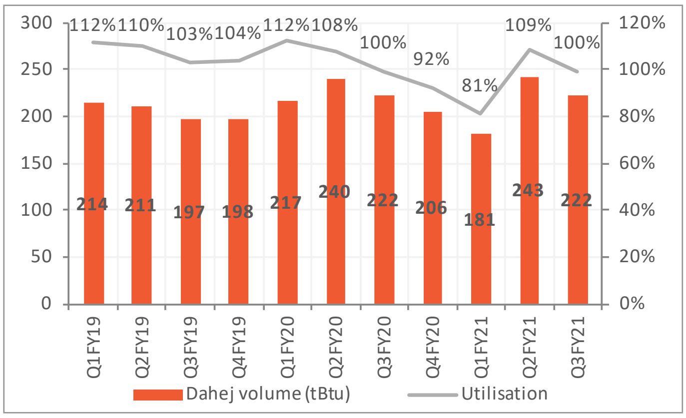
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	38,395	35,452	28,502	34,384	41,285
OPM (%)	8.9	11.3	16.5	14.9	13.6
Adjusted PAT	2,291	2,852	2,994	3,287	3,654
% YoY growth	*10.3*	*24.5*	*5.0*	*9.8*	*11.2*
Adjusted EPS (Rs)	15.3	19.0	20.0	21.9	24.4
P/E (x)	15.8	12.7	12.1	11.0	9.9
P/B (x)	3.6	3.3	3.2	3.0	2.5
EV/EBITDA (x)	9.5	8.0	6.5	5.9	4.9
RoNW (%)	23.2	27.1	26.7	27.9	27.5
RoCE (%)	27.3	24.9	26.1	27.4	27.8

Source: Company; Sharekhan estimates

Operating profit beats estimates on lower opex and inventory and trading gain on spot volumes

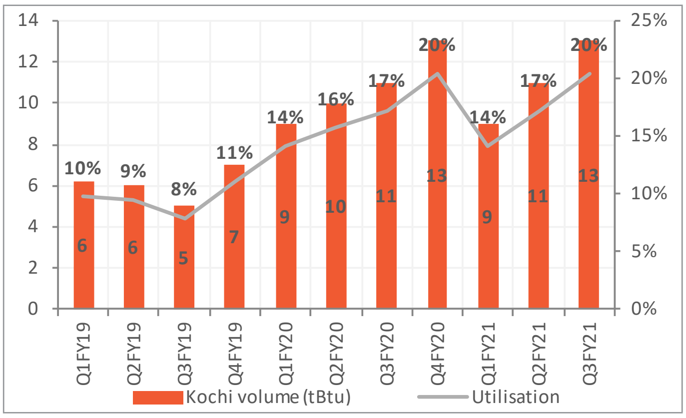
PLNG's Q3FY2021 operating profit at Rs. 1,335 crore (up 20.6% y-o-y; down 2% q-o-q) was well above our estimate of Rs. 1,143 crore due to: 1) lower-than-expected operating cost with a sharp 15.7%/19.4% y-o-y decline in employee cost/other expenses; 2) inventory gain of Rs. 60 crore, given spike in spot LNG price; and 3) Rs. 54 crore for trading gain on spot volume. However, Dahej volumes at 222tbtu (flat y-o-y; down 8.6% q-o-q) were 2% lower than our estimate of 227tbtu due to lower tolling volumes at 104 tbtu (down 23% q-o-q), partially offset by higher long-term contracted re-gas volume at 113tbtu (up 9.7% q-o-q). Kochi terminal's volume stood at 13tbtu (up 18.2% y-o-y and q-o-q). Dahej utilisation rate stood at 99.5% (versus 99.5% in Q3FY2020 and 109% in Q2FY2021) and Kochi utilisation was at 20.4% (versus 17.3% in Q2FY2021). PAT (adjusted for IND AS-116 and Rs. 60 crore inventory gain) at Rs. 811 crore (up 20.2% y-o-y; down 5.9% q-o-q) was above our estimate of Rs. 765 crore due to a sharp beat in operating profit.

Dahej terminal volume and utilisation



Source: Company, Sharekhan Research

Kochi terminal volume and utilisation trend



Source: Company, Sharekhan Research

Q3FY2021 results conference call highlights

- **Business update –** Management indicated that Dahej re-gas volume would decline on a sequential basis in Q4FY2021, given lower offtake for tolling contracts and spot basis due to a sharp rise in spot LNG price. However, demand is normalisiing now as spot LNG price corrected to $6.5-7/bbl from peak levels of $32/mmbtu.
- **Kochi-Mangalore pipeline update -** PLNG has guided that Kochi-Mangalore pipeline section has been commissioned in November 2020 and management expects to ramp-up volume to 1.5mmt with ~30% utilisation level by Q3FY2022-Q4FY2022 as more plants get connected over the pipeline route. Moreover, post the completion of Kochi-Bangalore section, utilisation of the Kochi terminal would further increase to 50%-60% in 2-3 years.
- **Dahej and Kochi re-gas tariff update –** Management highlighted that it has taken 5% annual escalation for Dahej re-gas tariff to Rs. 54.34/mmBtu with effect from January 1, 2021. With regards to Kochi terminal re-gas tariff, management is in discussions with off-takers at Kochi terminal for revision in re-gas tariff and a final decision on tariff is expected soon.
- **LNG dispensing infrastructure development update –** Management expects 8 million tonne-9 million tonne volume opportunity over the medium to long term from LNG dispensing business. PLNG is setting up five LNG dispensing stations on Delhi-Mumbai highway in collaboration with Gujarat Gas. The company has also tied up with IOCL and IGL for setting up of LNG dispensing stations.
- **Dahej LNG terminal expansion plan –** The company plans to expand Dahej terminal capacity to 19.5mmt in the next 2-3 years with the help of storage tanks and jetty. Moreover, in the next phase, the Dahej terminal capacity would further increase to 22.5mmt and capex for the additional 2.5mtpa-3mtpa capacity is estimated at Rs. 200 crore-250 crore.
- **Capex guidance –** The company has spent only Rs. 65 crore on capex in 9MFY2021 as against the initial capex guidance of Rs. 348 crore for the fiscal. FY2022 capex guidance is at Rs. 530 crore.

- The Board of Directors has approved the proposal for incorporating its wholly owned subsidiary company (Petronet Energy Limited) to undertake businesses, including gassing up and/or cool down and supply of heel to LNG vessels, LNG bunkering, training, consultancy, other value-added marine, transport, and LNG services.
- The company has signed a non-binding agreement with Ministry of Petroleum and Natural Gas for setting up 100 compressed bio gas (CBG) plants with total capex estimated at Rs. 125 crore.
- The company is also keen to build LNG terminal ($300 million) in Sri Lanka and LNG terminal in east coast of India. The east coast terminal is expected in the next four years with the target to book at least 30% of capacity at its proposed terminal.
- Gorgon volume at Dahej terminal was at 11tbtu in Q3FY2021 versus 7.5tbtu in Q2FY2021 and 8tbtu in Q1FY2020. Re-gas income stood at Rs. 607 crore as compared to Rs. 678 crore in Q2FY2021 versus Rs. 500 crore in Q1FY2021.

Results Rs cr

Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %
Net Sales	7,328	8,910	-17.8	6,236	17.5
Total Expenditure	5,993	7,803	-23.2	4,873	23.0
Reported operating profit	**1,335**	**1,108**	**20.6**	**1,363**	**-2.0**
Adjusted operating profit	**1,335**	**1,108**	**20.6**	**1,363**	**-2.0**
Other Income	111	84	32.0	160	-30.4
Interest	82	94	-13.3	85	-4.1
Depreciation	192	196	-1.8	195	-1.4
PBT before one-time items	1,172	902	30.0	1,243	-5.7
Reported PBT	**1,172**	**902**	**30.0**	**1,243**	**-5.7**
Exceptional income/(expense)	90	0	NA	88	2.3
Adjusted PBT	**1,082**	**902**	**20.0**	**1,155**	**-6.3**
Tax	294	227	29.7	315	-6.8
RPAT	878	675	30.1	927	-5.3
Adjusted PAT	**811**	**675**	**20.2**	**862**	**-5.9**
Equity Cap (cr)	150	150		150	
Reported EPS (Rs.)	5.9	4.5	30.1	6.2	-5.3
Adjusted EPS	5.4	4.5	20.2	5.7	-5.9
Margins (%)			***BPS***		***BPS***
Adjusted OPM	18.2	12.4	579	21.9	-364
Effective tax rate	25.1	25.1	-5	25.4	-30
NPM	11.1	7.6	349	13.8	-275

Source: Company; Sharekhan Research

Operating performance

Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %
Capacity utilisation – Dahej (%)	99.5	99.5	0	108.9	-941
Capacity utilisation – Kochi (%)	20.4	17.3	314	17.3	314
Total volume (TBTU)	**235.0**	**233.0**	**0.9**	**254.0**	**-7.5**
Long term volume – Dahej	113.0	102.0	10.8	103.0	9.7
Tolling volume – Dahej	104.0	111.0	-6.3	135.0	-23.0
Spot volume – Dahej	5.0	9.0	-44.4	5.0	0.0
Total Dahej volume (TBTU)	**222.0**	**222.0**	**0.0**	**243.0**	**-8.6**
Long term volume – Kochi	8.0	9.0	-11.1	8.0	0.0
Tolling volume – Dahej	3.0	2.0	NA	0.0	NA
Spot volume – Dahej	2.0	0.0	NA	3.0	NA
Total Kochi volume (TBTU)	**13.0**	**11.0**	**18.2**	**11.0**	**18.2**

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, and 3) low domestic gas prices and affordable LNG prices and government's aim to increase the 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.

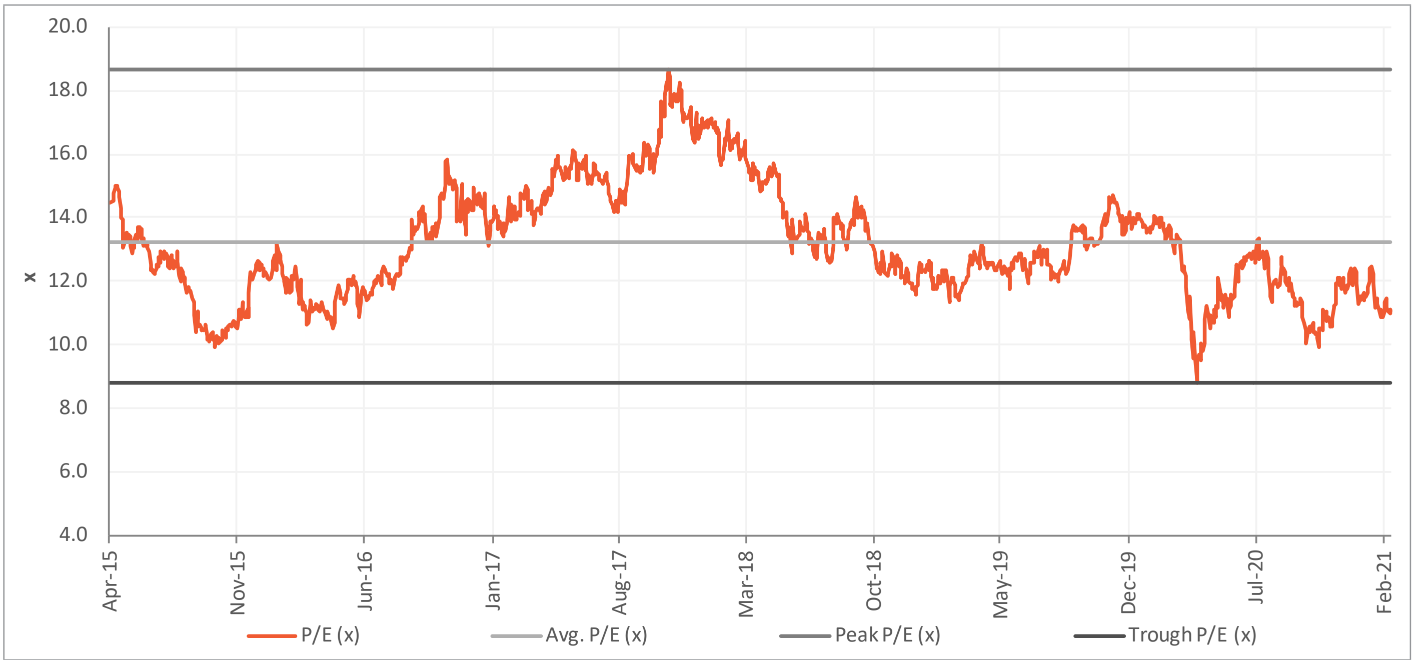
■ Company outlook - Sharp recovery in re-gas volume above pre-COVID-19 level provides earnings growth visibility

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 18%/26% in FY2022E/FY2023E from ~17% in 9MFY2021. The company's competitive edge (lowest tariff in the industry) would also help it hike annual re-gas tariffs (increased by 5% to Rs. 54.34/mmbtu from January 2021). 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 an unchanged PT of Rs. 300

We have fine-tuned our FY2021 earnings estimate as lower Dahej terminal utilisation assumption for Q4FY2021 gets offset by lower operating cost. We have marginally lowered our FY2022-FY2023 earnings estimates to factor lower utilisation for Kochi terminal. Sharp volume recovery provides strong earnings visibility (expect a 10% earnings CAGR over FY2021E-FY2023E) along with high RoE/RoCE at ~28% (superior among gas utilities). Moreover, PLNG's valuation of 9.9x its FY2023E EPS seems attractive as it is at a steep 25% 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 9%/6%, and non-regulated business model. Hence, we maintain our Buy rating on PLNG with an 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 volumes 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 22.5 mmt over the next 3-4 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 28%, FCF yield of 9%, 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.
- Non-revision of re-gas tariffs on a yearly basis.

Additional Data

Key management personnel

Tarun Kapoor	Chairman
VK Mishra	Managing Director & CEO
Rakesh Chawla	Director - Finance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BlackRock Inc	3.3
2	FMR LLC	2.9
3	Kotak Mahindra Asset Management Co	2.5
4	Vanguard Group Inc/The	1.5
5	Capital Group Cos Inc/The	1.2
6	Republic of Singapore	1.1
7	Norges Bank	1.0
8	JPMorgan Chase & Co	0.9
9	Robeco Luxembourg SA	0.8
10	T Rowe Price Group Inc	0.6

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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